88-589

No.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1988

**MICHAEL SULLIVAN,**

*Petitioner,*

v.

**HARTFORD ACCIDENT & INDEMNITY COMPANY,**

*Respondent,*

and

**FORD CITY BANK,**

*Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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## QUESTIONS PRESENTED

1. Does a federal district court, sitting in diversity, have ancillary jurisdiction to hear a third-party complaint brought by a defendant, where the third-party defendant is non-diverse, but the original and third party complaints are factually interdependent and involve precisely the same proof, and their resolution in a single proceeding will conserve judicial resources and prevent the potential for inconsistent verdicts?

2. Consistent with Rule 52 and prior decisions of this Court, including *Anderson v. Bessemer City*, 470 U.S. 564 (1985), and *Amadeo v. Zant*, 108 S. Ct. 1771 (1988), may a court of appeals substitute its own findings of fact for those made by an experienced trial judge who heard the evidence, observed the demeanor of the witnesses, and judged the credibility of testimony, when the trial judge's findings are amply supported by the trial evidence?

## PARTIES TO THE PROCEEDING

Petitioner Michael Sullivan is an individual. Respondents Hartford Accident and Indemnity Company and Ford City Bank are corporations. In addition to the parties identified in the caption of this case, Bruce Beede, Richard Orlak, and William Quinn were parties to this case in the district court. They settled or defaulted prior to trial and were not involved in proceedings on appeal.

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| QUESTIONS PRESENTED | i |
| PARTIES TO THE PROCEEDING | i |
| TABLE OF AUTHORITIES | iii |
| OPINIONS BELOW | 1 |
| JURISDICTIONAL STATEMENT | 2 |
| STATUTE INVOLVED | 2 |
| STATEMENT | 3 |
| Introduction | 3 |
| The Transaction At Issue | 4 |
| District Court Proceedings | 5 |
| Proceedings on Appeal | 6 |
| REASONS FOR GRANTING THE WRIT | 8 |
| I. | |
| THE SEVENTH CIRCUIT'S DETERMINATION THAT THE DISTRICT COURT LACKED JURISDICTION OVER SULLIVAN'S THIRD PARTY CLAIM IGNORES SETTLED LAW AND CREATES A CONFLICT AMONG THE CIRCUITS | 9 |
| II. | |
| BY SUBSTITUTING ITS FACTUAL FINDINGS FOR THOSE OF THE DISTRICT COURT, THE SEVENTH CIRCUIT DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS | 14 |
| CONCLUSION | 21 |

# TABLE OF AUTHORITIES


| *Cases* | PAGE |
|---|---|
| *Amadeo v. Zant*, 108 S. Ct. 1771 (1988) ..... | i, 15 |
| *Anderson v. Bessemer City*, 470 U.S. 564 (1985) .. | i, 15 |
| *Christmas v. Sanders*, 759 F.2d 1284 (7th Cir. 1975) ..... | 15 |
| *Field v. Volkswagenwerk AG*, 626 F.2d 293 (3rd Cir. 1980) ..... | 11 |
| *H.L. Peterson Company v. Applewhite*, 383 F.2d 430 (5th Cir. 1967) ..... | 10 |
| *Moor v. County of Alameda*, 411 U.S. 693 (1973) .. | 7 |
| *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365 (1978) ..... | 11, 12, 13, 14 |
| *Rogers v. Aetna Casualty and Surety Co.*, 601 F. 2d 840 (5th Cir. 1979) ..... | 10 |
| *Saalfrank v. O'Daniel*, 533 F.2d 325 (3d Cir.), *cert. denied*, 429 U.S. 922 (1976) ..... | 10 |
| *Sullivan v. Hartford Accident & Indemnity Company*, 846 F.2d 377 (7th Cir. 1988) ..... | *passim* |
| *United States v. Borelli*, 336 F.2d 376 (2d Cir. 1964), *cert. denied*, 379 U.S. 960 (1965) ..... | 18 |
| *United States v. Friedman*, 739 F.2d 252 (7th Cir. 1984) ..... | 15 |

| *Statutes and Rules* | |
|---|---|
| 28 U.S.C. § 1254(1) (1986) ..... | 2 |
| 28 U.S.C. § 1332 (1986) ..... | 2, 3 |
| Federal Rule of Civil Procedure 52 ..... | 9 |

*Other Authorities*

3 J. Moore, *Moore's Federal Practice* (1987) ..... 10

6 C. Wright & A. Miller, *Federal Practice and Procedure* (1971) ..... 10

13 C. Wright, A. Miller, E. Cooper, *Federal Practice and Procedure* (2d ed. 1984) ..... 10

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Michael Sullivan respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

## OPINIONS BELOW

The opinion of the court of appeals (A-1)[1] is reported at 846 F.2d 377 (7th Cir. 1988). The memorandum opin-

[1] The district court's findings of fact and judgment, and the Seventh Circuit's slip opinion, judgment, and orders on rehearing, are found in the Appendix to this Petition and will be referred to as "A-____." The trial transcript will be referred to as "Tr."

ions of the United States District Court for the Northern District of Illinois (A-21) are not reported.

## JURISDICTIONAL STATEMENT

The opinion and judgment of the Seventh Circuit were issued on April 28, 1988 (A-1). On May 12, 1988, the Seventh Circuit extended until June 2, 1988 the time in which to file a petition for rehearing (A-19). The petition for rehearing and suggestion of rehearing *en banc*, which was timely filed, was denied on July 6, 1988 (A. 20). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1986).

## STATUTE INVOLVED

This case involves the doctrine of ancillary jurisdiction arising under 28 U.S.C. § 1332 (1986), which confers diversity jurisdiction upon the district courts. Section 1332, provides in relevant part that:

> (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and is between–
>
> (1) citizens of different States;
>
> (2) citizens of a State and citizens or subjects of a foreign state;
>
> (3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and

(4) a foreign state, defined in section 1603(a) of this title, as plaintiff and citizens of a State or different States.

28 U.S.C. § 1332(a) (1986).

## STATEMENT

### Introduction

Petitioner Michael Sullivan, an attorney, alerted William Quinn, an officer of Ford City Bank, that Richard Orlak, Sullivan's sometime client, and Bruce Beede, another bank officer, might be involved in a substantial fraud against the bank (Tr. 306). After an extensive investigation, in which Sullivan provided substantial assistance to the bank, it was determined that Sullivan's suspicions were correct. In addition, it was determined that Quinn also was involved in the fraud (A. 46). Ultimately, the bank made a demand upon Hartford Accident & Indemnity Company, its insurer, to recover more than $1 million in losses which the bank sustained because of Orlak's conspiracy (A-43). Hartford eventually paid the bank's claim, and then brought suit against Sullivan, as well as Orlak, Beede, and Quinn (A-43-44). Orlak, Beede, and Quinn, all of whom had pleaded guilty to federal criminal charges arising out of the fraud, quickly defaulted or settled (A-22). Sullivan, who was not charged in the criminal matter, chose to defend the suit. After lengthy proceedings, including a trial, the district court rejected Hartford's claim against Sullivan, finding that Sullivan had not participated in the fraud that injured the bank (A-46). The district court also entered judgment in Sullivan's favor on a counterclaim he filed against the bank, which the court decided pursuant to its ancillary jurisdiction (A-47-51).

On appeal, the Seventh Circuit reversed (A-1). The court overruled the district court's factual finding that Sullivan was not a participant in the fraud, finding that he initiated the fraud by introducing Orlak to the bank several years earlier (A-11). In addition, the Seventh Circuit held that the district court lacked subject matter jurisdiction over Sullivan's third party complaint (A-9).

**The Transactions At Issue**

In 1970, Sullivan introduced Orlak, his then-client, to the bank (A-25-26). Orlak, who was seeking a $6,000 loan, had declared bankruptcy eight years earlier, a fact which Sullivan disclosed to the bank (Tr. 636). The bank made the loan, and between 1970 and 1972, it made additional loans to Orlak totalling more than $500,000 (A-26). Sullivan was not involved in the negotiation of these loans (*id.*).

In 1972, Orlak asked the bank to finance the development of a subdivision called "Neuport Estates." With the assistance of Beede and Quinn, Orlak obtained a $250,000 loan, which was later increased to $270,000. Sullivan was Orlak's partner in the Neuport Estates project (A-27). As a party to the Neuport Estates loan, Sullivan pledged his interest in the property to secure the loan (A-30).

Following the Neuport Estates loan, the bank made 20 additional loans to Orlak, totalling an additional $2.5 million, to develop other properties (A-33-37). As subsequent events revealed, these loans were obtained through the fraud of Beede and Quinn. The district court later found, in a finding which the Seventh Circuit did not address, that "Sullivan was never told of the[se] loans . . . nor did he have any part either in the application for or the approval of the[ ] loans" (A-33).

Sullivan eventually became aware of these loans, and he later discovered that Orlak had done nothing to develop the properties on which the loans had been granted. Sullivan, who was a shareholder in the bank, reported his findings to Quinn, and the two men immediately toured Orlak's properties to assess the extent of Orlak's defalcation. After the problems were disclosed to the bank's president, Sullivan met daily with bank officials to clear up the trail left by Orlak's fraudulent financial dealings (Tr. 32-33, 306, 308-09).

Sullivan, who was a party only to the Neuport Estates loan, subsequently assigned his interest in the Neuport Estates property to the bank, in lieu of foreclosure (A-41). Unlike Orlak's other development projects, Neuport Estates was profitable. Thus, after improving and paying off the indebtedness on the Neuport Estates property, the bank was left with a substantial surplus (A-50). Rather than return the surplus to Sullivan, the bank simply applied the surplus against Orlak's other loans, to which Sullivan was not a party (A-41).

**District Court Proceedings**

Hartford brought this action against Sullivan to recover the sums which it paid to the bank under its insurance policy.[2] Jurisdiction was based on diversity of citizenship (A-22). Sullivan subsequently filed a third party complaint against the bank, alleging that it had misapplied the proceeds of its sale of his interest in Neuport Estates by using the profits of the sale to recoup losses the bank suffered on loans to which Sullivan was not a party (*id.*).

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[2] Hartford also brought suit against Orlak, Beede, and Quinn, all of whom quickly defaulted or settled (A-22).

After hearing the testimony of Quinn, Sullivan, and various bank officials, the district court issued a lengthy and detailed opinion containing findings of fact and conclusions of law (A-21). The district court found that Orlak, Quinn, and Beede were engaged in a conspiracy to defraud the bank, which resulted in the losses for which Hartford had compensated the bank. However, the court specifically found that Sullivan was not a party to this conspiracy (A-46). In addition, the court found that it was not necessary to determine whether the Neuport Estates loan was legitimate because the bank (and Hartford) had sustained no loss from that loan, which could not therefore be the predicate for any recovery against Sullivan (A-47). Indeed, the bank had profited handsomely from the Neuport Estates loan (A-50).

The district court also entered judgment for Sullivan, in an amount later found to be $280,000, on his third-party complaint. The district court found that the bank had violated its state law fiduciary duty of loyalty to Sullivan by misapplying the proceeds of the Neuport Estates loan to Orlak's indebtedness, rather than returning the surplus to Sullivan (A-50). Hartford and Ford City appealed.

**Proceedings on Appeal**

In an opinion written by Judge Posner, the Seventh Circuit reversed (A-1-16). The court of appeals first held that the district court lacked jurisdiction over Sullivan's third party complaint. Analogizing the third-party action to a counterclaim, the court of appeals analyzed the jurisdictional issue by proceeding to decide whether Sullivan's claim should be considered compulsory or permissive (A-6). Although the Seventh Circuit found fault with its own analogy, recognizing that impleader is always voluntary, the court nonetheless concluded that jurisdiction should

be denied on the ground that the original and third party complaints arose out of different transactions or occurrences (A-7, 8, 9). The court of appeals also mounted a general attack on the doctrine of ancillary jurisdiction, noting that it is a "purely judge-made doctrine," and asserting that its justification is "rather tenuous" (A-9). Acknowledging that its holding was irreconcilable with this Court's statement in *Moor v. County of Alameda*, 411 U.S. 693, 714-15 (1973) (footnote omitted), that "the exercise of federal jurisdiction over claims against parties as to whom there exists no independent basis for federal jurisdiction finds substantial analogues in the . . . context of third party claims," the court of appeals expressed doubt that this Court's prior "suggestion was intended, and if it was, we respectfully disagree with it" (A-9). Finally, the court acknowledged that its holding—which clearly requires that parallel and related cases be maintained in federal and state courts—would create "hardship," but not "injustice" (A-6).

The court of appeals also reversed the judgment entered in Sullivan's favor on Hartford's complaint (A-11). In doing so, the court of appeals simply overruled the district court's factual finding that Sullivan was not a member of the conspiracy that injured the bank.[3] The court of appeals agreed with the district court that the question was whether there was a single conspiracy to defraud the bank, of which Sullivan was a part, or two conspiracies—

[3] In addition to exposing Sullivan to liability exceeding $1 million, the court referred Sullivan's conduct to the Illinois Attorney Registration and Disciplinary Commission for investigation (A-15). Moreover, the court expressed surprise that Sullivan had not been prosecuted for his involvement (A-15). In truth, Sullivan was investigated by federal prosecutors, but unlike Orlak, Beede, and Quinn, Sullivan was not charged.

one to defraud the bank through Orlak's post-Neuport Estates loans (to which Sullivan was not a party), and a second (whether legitimate or not) to obtain the Neuport Estates loan. However, unlike the district court, which found that there were two separate conspiracies (in one of which Sullivan clearly was not involved), the court of appeals found that there was only one global conspiracy, and that Sullivan participated in it (A-11). The court of appeals tied Sullivan to the conspiracy because Sullivan (a) had introduced Orlak to the bank in 1970 (A-11, 12), and (b) allegedly had profited, through legal fees earned in connection with real estate closings, and through Orlak's continued borrowings (A-12, 13). Although the court of appeals made central findings of fact that were directly contrary to those contained in the district court's painstaking account of the evidence, it simply ignored those findings in preference to its own.

On July 6, 1988, the Seventh Circuit denied Sullivan's petition for rehearing and suggestion of rehearing *en banc* (A-20).

## REASONS FOR GRANTING THE WRIT

The Seventh Circuit's decision, which severely constricts the ancillary jurisdiction of the district courts, and requires the filing of multiplicitous litigation to resolve closely related claims, conflicts with prior decisions of this Court and with decisions of other courts of appeals. Because of the conflict of authority on this point, the wasteful deployment of judicial resources mandated by the Seventh Circuit's decision, and the possibility of inconsistent results which will flow from the multiplicitous pro-

ceedings required by the Seventh Circuit's rule, further review is warranted.

By disregarding, without explanation, the district court's detailed factual findings, and by substituting its own factual findings for those of the experienced trial judge who heard the evidence and observed the demeanor of the witnesses, the court of appeals cavalierly disregarded the limits placed upon it by Federal Rule of Civil Procedure 52(a), and so far departed from the accepted and usual course of judicial proceedings as to require that this Court exercise its supervisory power.

## I.

## THE SEVENTH CIRCUIT'S DETERMINATION THAT THE DISTRICT COURT LACKED JURISDICTION OVER SULLIVAN'S THIRD PARTY CLAIM IGNORES SETTLED LAW AND CREATES A CONFLICT AMONG THE CIRCUITS.

The Seventh Circuit ruled that the district court lacked subject matter jurisdiction over Sullivan's successful third party claim because Sullivan and the bank were both Illinois citizens, and thus non-diverse. Noting that the original and third-party complaints involved "considerable factual overlap," but not the "same transaction or occurrence," a concept to which the court gave an extremely narrow construction, the Seventh Circuit held that the district court lacked jurisdiction over Sullivan's third-party complaint (A-9). That holding conflicts with prior decisions, both of this Court and of other courts of appeals, and it disregards the sound policy grounds supporting the exercise of ancillary jurisdiction.

1. The Seventh Circuit's cramped view of ancillary jurisdiction conflicts with the case law of other circuits. Indeed, it is hornbook law that a district court may exer-

cise ancillary jurisdiction over a non-diverse impleaded party ty on a related claim. 3 J. Moore, *Moore's Federal Practice* ¶ 14.26 at 14-108 (1987); 13 C. Wright, A. Miller, E. Cooper, *Federal Practice and Procedure* § 3523 at 109-12 (2d ed. 1984); 6 C. Wright & A. Miller, *Federal Practice and Procedure* § 1444 at 223 (1971).

The decision at bar directly conflicts with the Fifth Circuit's decision in *Rogers v. Aetna Casualty and Surety Co.*, 601 F.2d 840, 843 & n.4 (5th Cir. 1979). In that case, plaintiff Rogers sued Aetna in diversity, claiming that Aetna wrongfully denied coverage for an insurance loss. After denying coverage, Aetna filed a third-party complaint against two defendants whose negligence Aetna blamed for the loss. Under the Seventh Circuit's holding, Aetna's third-party complaint was not compulsory, because it involved a transaction different from that involved in Rogers' breach of contract action. (After all, Aetna's liability in contract did not turn on the third parties' liability in tort, which could be prosecuted in state court.) Nonetheless, the Fifth Circuit held that the district court had ancillary jurisdiction to "adjudicate . . . a related claim based wholly upon state law asserted by the defendant against a non-diverse impleaded third-party defendant." *Id.* at 843 n.4. *See also H.L. Peterson Company v. Applewhite*, 383 F.2d 430, 433 (5th Cir. 1967).

The Seventh Circuit's decision also conflicts with the decisions of other circuits. In *Saalfrank v. O'Daniel*, 533 F.2d 325, 329 (3d Cir.), *cert. denied*, 429 U.S. 922 (1976), for example, the Third Circuit held that where diversity exists between plaintiff and defendant, there need not be any independent jurisdictional basis to hear the defendant's claims against a third-party defendant, against whom the plaintiff seeks no relief. *Saalfrank* prohibits the exercise of ancillary jurisdiction with respect to a *plain-*

*tiff's* claim against a non-diverse third party (*accord Owen Equipment & Erection Co.*, 437 U.S. 365, 377 (1978)), but recognizes that ancillary jurisdiction is proper where, as here, only the *defendant* pursues a claim against the third party. *See also Field v. Volkswagenwerk AG*, 626 F.2d 293, 298-99 (3rd Cir. 1980).

2. The Seventh Circuit's narrow view of ancillary jurisdiction is also contrary to this Court's decision in *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365 (1978). In *Owen Equipment*, this Court identified two requirements for the exercise of ancillary jurisdiction. First, the third-party action must have "logical dependence" upon the action-in-chief. Second, parties who have been "haled into court" against their will should be accorded latitude in bringing ancillary claims. (*Id.* at 376.) Both requirements are satisfied here.

*First*, Sullivan's third party claim is logically dependent upon the underlying diversity action. A finding that Sullivan was not liable to Hartford was critical to Sullivan's claim that the bank had breached its fiduciary duty to him when it misapplied the surplus proceeds of his Neuport Estates loan to pay Orlak's unrelated debts. Likewise, a judgment that Sullivan was liable to Hartford would have undermined Sullivan's claim for recovery, and any such judgment would have required reduction by the amount of the profit earned from the bank's sale of Sullivan's interest in Neuport Estates. Thus, the resolution of the third party complaint is logically dependent on the original complaint.[4]

[4] The original and third party complaints also were factually related. Hartford complained of Sullivan's complicity in an alleged fraud. Sullivan denied his involvement in the fraud and complained that the bank had appropriated his property, in violation of the bank's fiduciary duty to him, as part of the bank's effort to recoup its losses on the same scheme.

Requiring the litigation of these interdependent issues in separate forums could well result in inconsistent verdicts. For example, the federal district court could find (as it did) that Sullivan was not a party to the fraud, while the state court might have found, in an independent action, that Sullivan had participated in the fraud, and, thus, was not entitled to recover for breach of fiduciary duty. This case therefore illustrates the policy justification for ancillary jurisdiction which this Court noted in *Owen Equipment*—the need to avoid relitigating the same issue in separate cases. (437 U.S. at 377.) In addition, the possible benefits of collateral estoppel might cause one party to delay the proceedings in one case to achieve the collateral estoppel benefits of a judgment in the other case.[5]

*Second*, this Court noted in *Owen Equipment* that ancillary jurisdiction should be understood as a doctrine which typically protects parties haled into court against their will. (437 U.S. at 376.) Sullivan, as a defendant in the original action brought by Hartford, was haled into the federal court against his will to defend a diversity action involving only state law claims. The Seventh Circuit held, however, that Sullivan cannot pursue his counterclaim, which arose out of the same events and was found meritorious by the federal district court, unless he is willing to endure the expense of maintaining a parallel

[5] While the court of appeals addressed issues relating to *res judicata* (A-8), it did not address the injustice which collateral estoppel could cause under its view of the law. A finding in the Hartford case that Sullivan was not a part of the fraud would not bind the bank in subsequent litigation. On the other hand, a finding that Sullivan was a part of the fraud could have preclusive effect on Sullivan in subsequent litigation. Thus, the Seventh Circuit's formulation requires Sullivan to prevail on the same issue in two logically interdependent suits, in two separate forums, while a single ruling adverse to Sullivan in either forum can be preclusive.

action in the state courts. Thus, under the Seventh Circuit's formulation, diversity jurisdiction not only grants a federal forum to the foreign citizen, but denies the local resident the opportunity to try all related actions in a single case.

The Seventh Circuit's decision is therefore inconsistent with this Court's analysis in *Owen Equipment*, a case which the Seventh Circuit did not even acknowledge.

3. The decision below also ignores the public policy considerations which support the exercise of ancillary jurisdiction. As this Court has held, "Congress did not intend to confine the jurisdiction of the federal courts so inflexibly that they are unable to protect legal rights or effectively to resolve an entire, logically entwined lawsuit." *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365, 377 (1978). On the other hand, the Seventh Circuit conceded that its narrow view of ancillary jurisdiction, which requires the initiation of "parallel . . . lawsuits," would cause "hardship," no doubt to the judiciary as well as to the parties (A-6). Indeed, because the single issue of Sullivan's role in the transactions admittedly will have to be tried twice under the Seventh Circuit's formulation, the holding below clearly requires wasteful relitigation of the same "logically entwined lawsuit."

The kind of waste mandated by the Seventh Circuit's decision is well demonstrated by the substantial overlap in proof between the original and third party complaints in this case. Evidence showing that Sullivan was not a party to the fraud, which was critical to Sullivan's defense against the Hartford claim, also supported Sullivan's claim against the bank, and vice versa. Indeed, the bank conceded at trial that the two complaints were related, noting that "a great deal of [the bank's] evidence will duck-tail [sic] with" Hartford's (Opening St. Tr. 5). In fact, the bank

presented no witnesses, relying entirely upon those called by Hartford. In this case, therefore, the original and third-party complaints involved precisely the same issues and proof.

In sum, the Seventh Circuit's decision presents an issue critical to the administration of justice in the federal courts. Unless corrected, the Seventh Circuit's decision will require the wasteful relitigation of interdependent lawsuits, and, due to the doctrine of collateral estoppel, will permit one party to a controversy, but not both, to relitigate contested factual issues. Moreover, the Seventh Circuit's decision is contrary to the decisions of other courts of appeals, to this Court's decision in *Owen Equipment*, and to the principles of judicial economy underlying the doctrine of ancillary jurisdiction. For all of these reasons, this case warrants further review.

## II.

## BY SUBSTITUTING ITS FACTUAL FINDINGS FOR THOSE OF THE DISTRICT COURT, THE SEVENTH CIRCUIT DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS.

The central issue at trial, as the Seventh Circuit correctly noted, was "whether there were two conspiracies—one centering on the loan for Neuport Estates, the other on the loans to Orlak—or one giant conspiracy to defraud the bank, with the loan to Neuport Estates just one component of it" (A-11). The district court found that there were two "conspiracies": (1) the Neuport Estates transaction, which may well have been a legitimate transaction, and to which Sullivan was a party, and (2) a broader unlawful conspiracy, in which Sullivan was not involved (A-46-47). The Seventh Circuit, without a single citation to the record, simply rejected these findings, and found

that a single conspiracy existed (A-11). Because the Seventh Circuit's decision constitutes a substantial departure from the usual and accepted course of judicial proceedings, and is contrary to the limits imposed by Rule 52(a), this case warrants further review.

1. The Seventh Circuit correctly noted that Sullivan's role presented a question of fact (A-13). Thus, the district court's finding that Sullivan was not a member of Orlak's larger conspiracy could be set aside only if it was "clearly erroneous." Fed. R. Civ. P. 52(a).[6] In the case at bar, however, the court of appeals did not hold that the district court's findings of fact were clearly erroneous. The court of appeals simply ignored those findings and substituted its own findings of fact in their place and stead. The court of appeals not only trampled on the proper functions of the district court, in violation of Rule 52(a), but created findings for which there is no support in the record.

2. Unlike the district court, the Seventh Circuit made a "finding" that Sullivan was involved in a fraudulent scheme prior to the 1972 Neuport Estates loan. The court of appeals supported this finding with two supposed "facts": (a) Sullivan assisted Orlak's initial "fraudulent"

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[6] It is settled law that an appellate court must credit factual findings if they are "plausible in light of the record viewed in its entirety," and it cannot disregard those findings "simply because it is convinced that it would have decided the case differently." *Anderson v. Bessemer City*, 470 U.S. 564, 573-74 (1985). It is not the province of an appellate court to retry the evidence or to draw different inferences from the facts. *Id.* at 574-75. The trial judge, of course, is uniquely situated to judge the credibility of witnesses, and findings based on credibility determinations "can virtually never be clear error." *Id.* at 575; *Amadeo v. Zant*, 108 S. Ct. 1771, 1778 (1988); *United States v. Friedman*, 739 F.2d 252, 255 (7th Cir. 1984). Finally, a party's testimony is itself sufficient to meet the requirement that a judgment be based upon substantial evidence. *Christmas v. Sanders*, 759 F.2d 1284, 1289 (7th Cir. 1975).

$6,000 loan by recommending Orlak to the bank in 1970, without disclosing Orlak's 1962 bankruptcy (A-11, 12); and (b) Sullivan was "aware" of Ford City's pre-Neuport Estates loans to Orlak (A-2). It is the Seventh Circuit's findings, rather than those of the district court, that are clearly erroneous.

The court of appeals' assertion (A-11) that Sullivan recommended Orlak "to [bank officer] Quinn without disclosing Orlak's previous bankruptcy" is both central to the Seventh Circuit's holding and directly contrary to the record evidence. Sullivan testified that he disclosed Orlak's 1962 bankruptcy when he introduced Orlak to the bank in 1970 (Tr. 636). Not only was that fact corroborated by Quinn, who testified that Orlak's bankruptcy was noted in the bank's credit files (Tr. 96), but there was *no* contrary evidence on the point. Thus, the Seventh Circuit's central assertions (A-11, 12)—that "Sullivan . . . launched what turned out to be a continuing scheme for defrauding the bank," "was instrumental" in the creation of the fraud, and "was directly involved in two fraudulent loans"—are simply false. Uncontroverted evidence showed that Sullivan disclosed, and the bank was aware of, Orlak's 1962 bankruptcy.[7]

The court's second shred of evidence linking Sullivan to the scheme to defraud was his purported "awareness"

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[7] Moreover, even if the court of appeals were correct in its assertion that Sullivan had failed to disclose Orlak's prior bankruptcy, the district court, as the finder of fact, was not required to infer from this "fact" that Sullivan committed fraud. It was Orlak who misrepresented his prior financial history (albeit unsuccessfully, because of Sullivan's disclosure), and there is no evidence that Sullivan even knew of Orlak's attempt to mislead the bank. Moreover, it was the duty of the bank, not Sullivan, to investigate Orlak's credit history before extending over $3 million in credit.

of Ford City's loans to Orlak from 1970 to 1972. The Seventh Circuit acknowledged that Sullivan was *not* involved in the negotiation of these loans, but the court observed that Sullivan, as Orlak's lawyer, "was aware of them" (A-2, 12).[8] The Seventh Circuit did not question the district court's finding that "Orlak personally applied to the bank for these loans; Sullivan neither recommended them nor had any part in their being applied for or processed at the bank" (A-26). Moreover, the trial evidence showed that Sullivan believed that Orlak obtained these additional loans legitimately; Orlak had partners (not including Sullivan) in these projects (Tr. 718).

The district court's finding—that Sullivan was not a member of Orlak's conspiracy—is certainly not an impermissible inference to be drawn from the existence of these loans and Sullivan's lack of participation in them. Thus, the contrary inference drawn by the Seventh Circuit—that Sullivan "launched" the scheme to defraud in 1970—was not the only reasonable inference to be drawn, and the trial court's refusal to draw it, in light of all the evidence and the trial court's ability to evaluate the credibility of the witnesses, was not "clearly erroneous."

3. After the Neuport Estates loan, Ford City approved 20 additional loans to Orlak. The district court found, in a finding that the court of appeals did not dispute, that "Sullivan was never told of the loans . . . nor did he have any part either in the application for or the approval of

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[8] The Seventh Circuit opinion does not explain how Sullivan learned of these loans. He learned of some by accident: "[i]n one transaction in 1972, for example, Sullivan sold a piece of property to Orlak and Ford City Bank provided the financing" (A-26). The district court found Sullivan learned of other loans, not as a co-conspirator, but "in his capacity as Orlak's lawyer" (*id.*).

these loans" (A-33). These loans, for $2,524,847.50 in principal (A-37), were the major source of the bank's losses to Orlak. Only by finding (contrary to the findings made by the trial judge) that Sullivan remained part of the conspiracy could the court of appeals hold Sullivan liable for these losses. The court provided the connection with the following "clear and convincing evidence": (a) Sullivan knew of "fraudulent loans" which were used to pay interest on the Neuport Estate loan (A-12); (b) he did not "blow the whistle" on Orlak (A-13), and (c) he benefitted from the loans (A-12). This "evidence" is no more substantial than was the "evidence" of Sullivan's "launching the fraud."

The court of appeals stated that Sullivan knew that Orlak continued to obtain "fraudulent" loans, using some of the money to pay interest on the Neuport Estates loan (A-12). As subsequent events revealed, the loans were fraudulent. However, there was *no* evidence to show that Sullivan knew the loans were fraudulent at the time that they were made. Indeed, there was *no* evidence to show that Sullivan even knew about the loans until long after they had been made. While Sullivan later became aware of some of the loans, the essence of a civil conspiracy, as the court of appeals correctly noted (A-10), is agreement, not awareness. *See United States v. Borelli*, 336 F.2d 376, 384 (2d Cir. 1964), *cert. denied*, 379 U.S. 960 (1965). The trial evidence showed no agreement between Orlak and Sullivan to obtain money by false pretenses; at most, the evidence showed that Sullivan knew about the loans after the fact. Moreover, as to the application of these loan proceeds to the Neuport Estates project, Sullivan testified that he promised to reimburse Orlak for any advances which Orlak might make to Neuport Estates (Sullivan Dep. 246). Other evidence, which the Seventh Circuit completely disregarded, also showed that Sullivan

was not a party to the post-Neuport Estates fraud. For example, the evidence showed that Sullivan, when he discovered Orlak's problems on other projects, told him to solve them (Tr. 286-87), and that Sullivan inquired of Orlak concerning the payment of interest on the Neuport Estates loan (Tr. 300).

The court of appeals also supported its "finding" by asserting that Sullivan "did not blow the whistle" (A-13). In fact, however, it was Sullivan—and no one else—who "blew the whistle" on Orlak by telling bank officer Quinn about the irregularities involving Beede and Orlak (Tr. 32-33, 306), by touring Orlak's developments with Quinn to discover the extent of the scheme (*id.*), and by meeting on a daily basis with bank officials in an attempt to uncover the extent of the fraud and solve the problems created by Orlak (*id.* at 308-09).[9]

Finally, the court of appeals' assertion (A-12) that Sullivan benefitted from Orlak's "enlarged . . . demand" for his legal services is pure speculation. There is no evidence to show that Sullivan knowingly aided the conspirators or even knew of Orlak's activities on the post-Neuport Estates loans. Nor is there any evidence to show that Sullivan "enlarged" the "demand" for his services. The evidence shows that Sullivan assisted Orlak only at occasional real estate closings; he did not participate in any other way.

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[9] The Seventh Circuit indicated that it was troubled by the fact that Sullivan owned stock in the bank (A-13). That fact is indeed troubling, but for reasons other than those mentioned by the court of appeals. Not only was Sullivan a stockholder, but he invested an additional $28,000 in bank stock only five months before he discovered—and disclosed—Orlak's fraud (Tr. 659). Had he been involved in the fraud, he certainly would not have invested his money in a bank that faced a certain loss of over $1 million because of Orlak's fraud.

4. In sum, the evidence does not compel the inference that Sullivan joined Orlak's conspiracy after the Neuport Estates loan, and the district court's finding that Sullivan was not part of the fraud, which is supported by substantial evidence, is not clearly erroneous. As Hartford's counsel conceded at trial, the issue of Sullivan's participation in the larger conspiracy turned largely on questions of credibility (Tr. 577). The experienced trial judge, having to choose in some instances between the credibility of Quinn and Sullivan (Tr. 348), actively participated in the questioning of both witnesses (*see, e.g.*, Tr. 341-49, 781-87), and ultimately found Sullivan more credible than Quinn, who had been convicted of a felony (Tr. 2). It was up to the trial judge, and not the court of appeals, to make this choice.

The Seventh Circuit's treatment of the trial evidence well demonstrates the wisdom of the rule prohibiting appellate courts from retrying cases on appeal. Indeed, the Seventh Circuit's "factual findings" have exposed Sullivan, whose demeanor and credibility it has never observed, to potentially devastating civil liability, as well as the possible loss of his professional license. The district court's contrary findings of fact are not "clearly erroneous," and, by disregarding them, the court of appeals departed from the accepted and usual course of judicial proceedings. For this reason as well, this case warrants further review.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: October 4, 1988

* Counsel of Record

No. 88-589

SUPREME COURT
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1988

**MICHAEL SULLIVAN,**

*Petitioner,*

v.

**HARTFORD ACCIDENT & INDEMNITY COMPANY,**

*Respondent,*

and

**FORD CITY BANK,**

*Respondent.*

## APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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## INDEX TO APPENDIX


| | PAGE |
|---|---|
| Opinion of the Court of Appeals, August 28, 1988 .. | A-1 |
| Order and Judgment of the Court of Appeals, April 28, 1988 ..... | A-17 |
| Order of the Court of Appeals Granting Extension of Time in Which to File Petition for Rehearing, May 12, 1988 ..... | A-19 |
| Order of the Court of Appeals Denying Petition for Rehearing and Suggestion for Rehearing *En Banc*, July 6, 1988 ..... | A-20 |
| Memorandum Containing Findings of Fact and Conclusions of Law of the District Court, May 27, 1983 ..... | A-21 |
| Judgment Order of the District Court, April 17, 1987 ..... | A-52 |

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## APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

# IN THE
# UNITED STATES COURT OF APPEALS
# FOR THE SEVENTH CIRCUIT

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Nos. 87-1784, 87-1843

HARTFORD ACCIDENT AND INDEMNITY COMPANY,

*Plaintiff-Appellant,*

*v.*

MICHAEL SULLIVAN,

*Defendant-Third-Party-Plaintiff-Appellee,*

*v.*

FORD CITY BANK,

*Third-Party-Defendant-Appellant.*

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Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 76 C 3319—**George N. Leighton,** *Judge.*

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ARGUED FEBRUARY 8, 1988—DECIDED APRIL 28, 1988

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Before POSNER, COFFEY, and EASTERBROOK, *Circuit Judges.*

POSNER, *Circuit Judge.* This diversity case presents questions of federal jurisdiction and Illinois tort law in an unseemly setting of bank fraud and attorney misconduct. In the early 1970s Michael Sullivan, a successful real estate lawyer and broker and a stockholder of the Ford City Bank, would refer clients to William Quinn, an officer of the bank, for loans and other bank services. In exchange Quinn would refer legal business to Sullivan.

(Sullivan may have violated the Illinois Code of Professional Responsibility, which in Canon 2 provides that "a lawyer shall not promise or give another person anything of value to initiate a contact with a prospective client on behalf of the lawyer." Ill. Rev. Stat. ch. 110A, Rule 2-103(d).) One of Quinn's customers was Richard Orlak. He was a tile contractor with ambitions to be something grander, and a client of Sullivan. In February 1970 he wanted to borrow $6,000, but he could not obtain a loan in that amount from any bank because of his poor credit history, which included a bankruptcy. He turned to Sullivan for help, and Sullivan, although he knew about the bankruptcy, recommended Orlak to Quinn, who approved Orlak's application for the loan. Orlak did not disclose his bankruptcy on the application, although the application form required him to list all bankruptcy proceedings in which he had been involved.

The $6,000 loan inaugurated a substantial relationship between Orlak and the Ford City Bank. By the summer of 1972, Orlak, through a series of loans approved by Quinn and by another bank officer, Bruce Beede, owed the bank some $500,000. Sullivan did not participate in the negotiations for these loans, but, as Orlak's lawyer, was aware of them.

That summer Orlak got wind of an unimproved 17-acre parcel of land, later dubbed Neuport Estates, that was for sale for $190,000. Beede, Quinn, Orlak—and Sullivan—hatched a fraudulent plan to obtain financing for the purchase and development of the parcel. This plan included the formation of a partnership, in which Orlak and Sullivan would be disclosed partners and Quinn and Beede undisclosed ones, to buy the land; the concealment from the bank's executive committee not only of the undisclosed (and unlawful) partnership interests of the bank officers but also of Orlak's bankruptcy and of the purchase price; and the submission of an appraisal of the property as worth $540,000 developed, without revealing that it was as yet undeveloped. By means of these representations the partnership obtained a loan from the bank for $250,000,

later raised to $270,000. The loan was secured by the land, which was placed in a land trust ("Land Trust No. 300"). An Illinois land trust is like a mortgage, so the bank corresponded to a mortgagee and the partnership to a mortgagor. Sullivan signed a personal guarantee of the trust's debts. The guarantee figured in the trial, but as our disposition renders the guarantee issues moot we shall omit them to simplify the opinion.

For the next two years Orlak continued to borrow money fraudulently from the bank, using the good offices of Quinn and Beede. None of the loans was intended for the Neuport Estates project, and Sullivan, although he continued to represent Orlak, was not involved in negotiating any of them. However, Orlak used some of the proceeds of the loans to pay interest on the Neuport Estates loan—and Sullivan knew this, as he admitted in his deposition, and he also knew that Orlak was in financial trouble. Also during this period Sullivan received covert, plainly irregular cash payments from Beede. The source of these funds was the other loans, but Sullivan testified that he thought the source was the Neuport Estates loan, and the judge believed him.

Orlak's house of cards collapsed in June 1974, when Quinn, realizing that Orlak was insolvent and hoping to save his own hide, 'fessed up to the president of the Ford City Bank. Orlak shortly defaulted, owing the bank more than $2.5 million. The bank demanded that Sullivan sign over his interest in Neuport Estates, and he complied. Although the bank ended up some $1.5 million in the hole after foreclosing on Orlak's loans, Neuport Estates turned out to be one of his happier projects; the bank was able to complete and sell the project for more than the unpaid balance of the $270,000 loan and the costs of completion. It applied the proceeds of the sale to Orlak's other loans.

Hartford Accident and Indemnity Company had insured Ford City Bank against defalcations by its officers. Hartford settled Ford City's indemnity claim against it for $1.25 million plus an assignment of Ford City's legal

rights. Hartford is not a citizen of Illinois, so it was able to sue the bank officers, Orlak, and Sullivan—all of whom are citizens of Illinois, as is Ford City Bank—in federal district court. The suit charged a civil conspiracy. Only Sullivan fought the suit; the others, who unlike Sullivan had been prosecuted criminally, either settled or defaulted. Sullivan filed a third-party complaint against Ford City, seeking to recover the amount that Ford City had realized from the sale of Neuport Estates over and above the amount owed the bank under Land Trust No. 300. Sullivan's principal ground was that the bank had breached a fiduciary duty to him by applying the proceeds to Orlak's other loans. He also made this ground the basis of a counterclaim (really a set off) against Hartford.

Hartford's claim against Sullivan, and Sullivan's counterclaim against Hartford and third-party complaint against Ford City, were tried together, resulting in a decision by Judge Leighton that Sullivan was not liable to Hartford—because his participation in the conspiracy had been limited to the Neuport Estates loan, on which Ford City had lost no money—but that Ford City was liable to Sullivan to the tune of $280,000. The judge dismissed Sullivan's counterclaim against Hartford. Hartford and Ford City appeal from the judgments against them. Sullivan has not cross-appealed from the dismissal of the counterclaim.

It is convenient to take up the question of federal jurisdiction over the third-party complaint first, because that question raises in turn a question about jurisdiction over the main complaint. Since Sullivan and Ford City are citizens of the same state and their claims present no federal questions, the suit between them can be maintained in federal court, if at all, only under the doctrine of ancillary jurisdiction. Had Ford City agreed to indemnify Sullivan for any judgment that Hartford might obtain against him, Sullivan could cite much authority for deeming his third-party complaint within the federal courts' ancillary jurisdiction by reason of the great economy of trying such closely related claims in the same court. See, e.g., *Revere Copper & Brass Inc. v. Aetna Casualty & Surety Co.*,

426 F.2d 709 (5th Cir. 1970); *Pennsylvania R.R. v. Erie Avenue Warehouse Co.*, 302 F.2d 843, 844-45 (3d Cir. 1962). But, even more clearly, if Hartford had had claims against both Sullivan and Ford City arising out of Orlak's fraudulent course of borrowing, it could not have used the doctrine of ancillary jurisdiction to get around the requirement of complete diversity by first suing Sullivan and then impleading Ford City. See *Owen Equipment & Erection Co. v. Kroger*, 437 U.S. 365, 374 (1978); *American National Bank & Trust Co. v. Bailey*, 750 F.2d 577, 583 (7th Cir. 1984); cf. *Acton Co. v. Bachman Foods, Inc.*, 668 F.2d 76, 79-80 (1st Cir. 1982). This case is somewhere in between these examples of proper and improper invocation of ancillary jurisdiction, but we think it closer to the improper pole and therefore order the dismissal of the third-party action for lack of federal jurisdiction.

Since Hartford was suing Sullivan by virtue of an assignment of Ford City's rights, Sullivan could set up by way of defense to the suit any defenses he would have had if Ford City had sued him. And he did; he pleaded his claim to the return of his interest in Neuport Estates as a set off to Hartford's claim for the damages that he had caused the bank by his participation in a conspiracy to defraud it. However, he had no right to an affirmative judgment against Hartford, which had taken an assignment of Ford City's rights but not an open-ended assignment of Ford City's liabilities. His only method of obtaining an affirmative judgment was to sue Ford City Bank. But he could have done this (had Hartford not sued him first in federal court) only in state court, and if Hartford had later sued him in federal court he could not have consolidated his state court action with his federal court defense. It is only because Hartford sued him before he got around to suing Ford City in state court that he can argue that since he was hauled into federal court he ought to be able to try his entire "defense" there, one part of which is an offense against Ford City Bank (but as the saying goes, a good offense is the best defense).

The issues in the two suits are closely related, but they are not identical, nor logically entwined in the sense that

the decision in one suit would necessarily decide the other by operation of collateral estoppel or otherwise. None of the parties argues that if Hartford wins, Ford City must win, or that if Hartford loses, Ford City must lose. Hartford might for example have won only on Sullivan's personal guarantee, in which event it would be entirely possible for Ford City to lose on Sullivan's claim against it. Ancillary jurisdiction should be narrowly interpreted, in recognition that what is at stake is the sovereign right of the states to confine (so far as possible) to their own courts the litigation of issues of state law in disputes between their own citizens. The doctrine should not be used merely to enable state and federal suits to be consolidated in federal court whenever ordinary notions of judicial economy would make that a desirable result, but instead should be reserved for cases where failure to exercise federal jurisdiction would prevent a party from obtaining justice. This is not such a case. Having to bring parallel suits may be a hardship, but it is not an injustice. Had it not been for the accidents of timing, Sullivan would have found himself a plaintiff in state court, forced to litigate parallel but distinct lawsuits in different court systems as soon as Hartford sued him in federal court.

Many courts asked to establish the boundaries of ancillary jurisdiction in the setting of third-party claims draw an analogy to the distinction between compulsory and permissive counterclaims, the former arising out of the same "transaction or occurrence that is the subject matter of the" main claim, Fed. R. Civ. P. 13(a), the latter not, Fed. R. Civ. P. 13(b). Compulsory counterclaims are within the ancillary jurisdiction of the federal courts; permissive counterclaims are not. *American National Bank & Trust Co. v. Bailey, supra*, 750 F.2d at 583; *EVRA Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 959-60 (7th Cir. 1982); *Finkle v. Gulf & Western Mfg. Co.*, 744 F.2d 1015, 1018-19 (3d Cir. 1984); *H.L. Peterson Co. v. Applewhite*, 383 F.2d 430, 433 (5th Cir. 1967); *Moor v. County of Alameda*, 411 U.S. 693, 714-15 (1973) (dictum); 13 Wright, Miller & Cooper, Federal Practice and Procedure § 3523, at pp. 106-09 (2d

ed. 1984). The analogy is particularly apt in this case, given the close relationship between Ford City and Hartford as assignor and assignee; if they were one, Sullivan's third-party claim would be a counterclaim.

Rule 14(a), under which Sullivan necessarily proceeded in impleading Ford City Bank, appears to cut across the distinction between compulsory and permissive counterclaims; it allows the defendant to implead a third party "who is or may be liable to the third-party plaintiff [i.e., the original defendant—Sullivan] for all or part of the plaintiff's claim against the third-party plaintiff." The appearance may be deceptive, for it is hard to see how the condition we have just quoted could be fulfilled unless the third-party's liability was derivative, *Barab v. Menford*, 98 F.R.D. 455, 456 (E.D. Pa. 1983), and thus was readily seen to arise from the same dispute that gave rise to the plaintiff's claim. This is the usual situation. *Revere Copper & Brass Inc. v. Aetna Casualty & Surety Co.*, cited earlier, illustrates it. The defendant, Aetna, had agreed to insure the plaintiff, Revere, against a breach by Fuller (later the third-party defendant) of his performance bond. Fuller in turn had agreed to indemnify Aetna for any losses to Aetna resulting from the contract of suretyship. Fuller breached his bond, Revere sued Aetna on the suretyship, so Aetna impleaded Fuller. Although Fuller may have had defenses based solely on the terms of his agreement to indemnify Aetna, the dispositive issues in the third-party claim would probably be the same as in the main claim: had Fuller breached the performance bond, and if so what had this cost Revere? So ancillary jurisdiction of the third-party claim was upheld, by explicit analogy to compulsory counterclaims. See 426 F.2d at 716; *Mayer Paving & Asphalt Co. v. General Dynamics Corp.*, 486 F.2d 763, 772 (7th Cir. 1973); *United States v. City of Twin Falls*, 806 F.2d 862, 867 (9th Cir. 1986).

The analogy between counterclaims and impleader is not exact, however, and the result in these cases can therefore be questioned. A defendant who fails to plead a compulsory counterclaim in a federal suit may be barred from

bringing a state suit based on the same claim. See, e.g., *McDonald's Corp. v. Levine*, 108 Ill. App. 3d 732, 743, 439 N.E.2d 475, 487 (1982). Thus the filing of such a counterclaim, unlike the filing of a third-party claim, is in a sense involuntary, and it would be an injustice to the counterclaimant if the district court in effect barred his claim forever by refusing to exercise jurisdiction over it. But we are painting in too vivid colors. A defendant prevented by a jurisdictional ruling from filing a compulsory counterclaim is not likely, in fact, to be held to be barred from maintaining an independent suit on the same claim. A state court would have to be awfully severe, or worse, to bar a claim that the plaintiff could not have asserted as a counterclaim, no matter how hard he had tried, because the court in which the main claim had been filed would not have exercised jurisdiction over the counterclaim. The forfeiture of a claim that should have been but was not raised as a compulsory counterclaim is based on principles of or akin to res judicata, and the analogy implies that if the claimant had no actual chance to bring a compulsory counterclaim the claim should not be forfeited. Cf. *Dindo v. Whitney*, 451 F.2d 1, 3 (1st Cir. 1971); *LaFollette v. Herron*, 211 F. Supp. 919 (E.D. Tenn. 1962). Indeed, it seems odd even to describe as a counterclaim a claim that cannot be brought as a counterclaim because it is outside the jurisdiction of the court in which the main claim is pending.

At all events, impleader clearly is voluntary. If Aetna had not impleaded Fuller, it could still have sought indemnity from him if it lost against Revere. Impleader was just a convenience. Maybe that should not be enough to allow a federal court to decide an issue of state law between two parties who are citizens of the same state, even if the issue arises out of the same transaction or occurrence that is the subject of the claim over which the court has unquestioned federal jurisdiction. So Judge Lumbard argued forcefully in dissent in *Dery v. Wyer*, 265 F.2d 804, 810-13 (2d Cir. 1959), but the argument thus far has fallen on deaf ears. We need go no deeper into the

question. The proper analogy to Sullivan's claim against Ford City Bank is permissive, not compulsory, counterclaim. Hartford's claim against Sullivan arises out of the fraudulent scheme by Orlak and others to defraud the bank, while Sullivan's claim against the bank arises out of the bank's efforts to cut its losses by foreclosing the Neuport Estates loan after the frauds were discovered. The claims involve considerable factual overlap, of course, but they arise at different times from different events, and thus flunk the test of same transaction or occurrence. That is the proper test to use in determining which Rule 14(a) claims are within the federal courts' ancillary jurisdiction if the doctrine is narrowly construed in the impleader setting, as we think it should be, since the grounds for ancillary jurisdiction (a purely judge-made doctrine) are rather tenuous in that setting as we have seen. Dicta in a few cases can be read to suggest that *any* 14(a) claim is within the ancillary jurisdiction of the federal courts, see *Moor v. County of Alameda, supra*, 411 U.S. at 715; *H.L. Peterson Co. v. Applewhite, supra*, 383 F.2d at 433, but it is doubtful that the suggestion was intended, and if it was we respectfully disagree with it.

If the two suits had been so closely related that *Sullivan v. Ford City Bank* was within the federal district court's ancillary jurisdiction, a question would arise whether Ford City's assignment to Hartford was effective in creating diversity jurisdiction, for it might then be viewed as a device for getting around the requirement of complete diversity. Assignments designed to confer diversity jurisdiction, normally for purposes of facilitating the collection of a debt, are collusive and ineffective. See 28 U.S.C. § 1359 ("A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court"); *Kramer v. Caribbean Mills, Inc.*, 394 U.S. 823 (1969); *Steele v. Hartford Fire Ins. Co.*, 788 F.2d 441, 444 (7th Cir. 1986). But there is no evidence that at the time of assignment Ford City Bank anticipated being named a third-party defendant, or

that the assignment was anything more than a natural sequel to the insurance contract; so the principle that collusive assignments do not invoke the federal diversity jurisdiction is not in play. As the wording of section 1359 indicates, if the assignment is not collusive or otherwise improper, the assignee's citizenship determines whether his suit is within the diversity jurisdiction. See, e.g., *Westinghouse Credit Corp. v. Shelton*, 645 F.2d 869, 870 (10th Cir. 1981).

We can therefore proceed to the merits of Hartford's claim, which is that the undisputed facts establish that Sullivan was a participant in the overall conspiracy with Orlak, Quinn, and Beede to defraud the Ford City Bank of millions of dollars, and not just in a lesser conspiracy to obtain a $270,000 loan, eventually repaid in full with interest, for the Neuport Estates project.

Relatively few Illinois cases deal with civil conspiracy, but enough to make clear that Illinois courts do not take an idiosyncratic view of this tort. See *Miller v. John*, 208 Ill. 173, 70 N.E. 27 (1904); *Wolf v. Liberis*, 153 Ill. App. 3d 488, 496, 505 N.E.2d 1202, 1208 (1987); *Dymek v. Nyquist*, 128 Ill. App. 3d 859, 866, 469 N.E.2d 659, 665 (1984); *Reiter v. Illinois National Casualty Co.*, 328 Ill. App. 234, 258, 65 N.E.2d 830, 942 (1946), rev'd on other grounds, 397 Ill. 141, 73 N.E.2d 412 (1947). So we can draw on general principles. A further simplification is made possible by the fact that courts treat civil and criminal conspiracy alike—apart of course from standard of proof and other respects in which civil and criminal procedure differ—so that the abundant precedents on the meaning of criminal conspiracy are available for use in the civil context.

A conspiracy is an agreement, *United States v. Borelli*, 336 F.2d 376, 384 (2d Cir. 1964) (Friendly, J.), but often an implicit one, and the scope of an implicit agreement—the issue here, as in so many other conspiracy cases, both civil and criminal—is hard to determine with precision. The best formulation may be Learned Hand's in *United States v. Andolschek*, 142 F.2d 503, 507 (2d Cir. 1944):

"a party to a conspiracy need not know the identity, or even the number, of his confederates; when he embarks upon a criminal venture of indefinite outline, he takes his chances as to its content and membership, so be it that they fall within the common purposes as he understands them. Nevertheless, he must be aware of those purposes, must accept them and their implications, if he is to be charged with what others may do in execution of them." See also *Bell v. City of Milwaukee*, 746 F.2d 1205, 1255 (7th Cir. 1984); *Halberstam v. Welch*, 705 F.2d 472, 481 (D.C. Cir. 1983).

The precise issue here is whether there were two conspiracies—one centering on the loan for Neuport Estates, the other on the other loans to Orlak—or one giant conspiracy to defraud the bank, with the loan for Neuport Estates just one component of it. These characterizations are not mutually exclusive, but only if the second is permissible can Sullivan be held liable for the losses inflicted on the bank (and hence on Hartford) by virtue of the other loans to Orlak. Everything depends on whether it can be said that the entire course of dealings with Orlak had a common purpose to which Sullivan knowingly subscribed, though he need not have been continuously involved in the fraudulent enterprise. See, e.g., *United States v. Davis*, 838 F.2d 909, 913 (7th Cir. 1988); *United States v. Noble*, 754 F.2d 1324, 1329 (7th Cir. 1985).

We consider this not only a permissible but an inescapable characterization, so that the district court clearly erred in rejecting it. The loan for Neuport Estates was the first in which Quinn and Beede were bribed. Sullivan was in the thick of this fraud; he was not only present at the creation, but instrumental in it. He was instrumental in a further sense. It was he who first introduced Orlak to the bank, and it was he who enabled Orlak to obtain a loan to which Orlak was not entitled; for he recommended the loan to Quinn without disclosing Orlak's previous bankruptcy, which Sullivan knew about. Sullivan was directly involved in two fraudulent loans; this is an admitted, not a contested, fact.

This participation would not by itself make him liable for all the subsequent acts of his fellow conspirators. There is no evidence that the agreement to obtain the loan for Neuport Estates was part of a broader agreement to siphon money from the bank to Orlak. Cf. *United States v. Melchor-Lopez*, 627 F.2d 886, 891-92 (9th Cir. 1980). Such an agreement undoubtedly was formed at some point in what became a continuing, indeed accelerating, scheme of fraudulent borrowing, but it was formed in the first instance among Orlak and the two bank officers, and the question is whether Sullivan joined the agreement. The conspiracy is a fact; the only question is whether Sullivan joined it. See, e.g., *United States v. Melchor-Lopez*, *supra*, 627 F.2d at 891. The evidence leaves no doubt that he did. Cf. *United States v. Percival*, 756 F.2d 600, 610-11 (7th Cir. 1985); *United States v. Marks*, 816 F.2d 1209, 1212 (7th Cir. 1987). Sullivan admits that he knew both that Orlak was continuing to obtain fraudulent loans from the bank and that some of this money was being used to pay interest due on the Neuport Estates loan. Thus, Sullivan not only launched what turned out to be a continuing scheme for defrauding the bank but also knew that the scheme was continuing, and knowingly benefited from the continuation. He also benefited indirectly from the continuing fraud, for by expanding Orlak's business it enlarged Orlak's demands for Sullivan's legal services. Though we certainly do not suggest that a lawyer by rendering services becomes a partner in his client's misdeeds, cf. *United States v. Anderson*, 542 F.2d 428, 436 (7th Cir. 1976), membership in the legal profession is not a shield against liability for conduct in excess of professional right or duty, see *Celano v. Frederick*, 54 Ill. App. 2d 393, 399-400, 203 N.E.2d 774, 778 (1964); *Wahlgren v. Bausch & Lomb Optical Co.*, 68 F.2d 660, 664 (7th Cir. 1934); Ill. Rev. Stat. ch. 110A, Rule 7-102 ("Representing a Client Within the Bounds of the Law").

The facts that we have recited were established by clear and convincing evidence, as required by Illinois courts in civil conspiracy cases. See, e.g., *Rosee v. Board of Trade*,

43 Ill. App. 3d 203, 239, 356 N.E.2d 1012, 1036 (1976). The question, also factual, is whether they establish Sullivan's participation in the broader conspiracy. Misled by a dictum in *Lektro-Vend Corp. v. Vendo Co.*, 660 F.2d 255, 263 (7th Cir. 1981), Sullivan makes the unguarded concession, which is incorrect and to which we shall not hold him, that "mixed" questions of fact and law, such as whether the facts add up to conspiracy, are not governed by the clearly-erroneous rule. The current view of this circuit is that, with immaterial exceptions, such "mixed" or "ultimate" questions are facts for purposes of the rule. See *Mucha v. King*, 792 F.2d 602, 605 (7th Cir. 1986); *Davenport v. DeRobertis*, No. 87-1233, slip op. at 2-3 (7th Cir. April 13, 1988).

A passage from an early Illinois case on civil conspiracy is apropros: "Abraham L. Day, although ignorant of what was intended, was indifferent and careless as to everything except the compensation promised him and his personal safety, and, by assisting to carry out the conspiracy, became a party to it." *Santee v. Day*, 111 Ill. App. 495, 502 (1903). Sullivan assisted the broader conspiracy by introducing Orlak to the bank in circumstances redolent of fraud and unethical conduct and by hatching the first full-scale loan fraud, that involving the loan for Neuport Estates, in which Sullivan was a principal. He did not blow the whistle—a clean way of terminating his participation in the fraud. Maybe as an officer of the court, and a stockholder of the victim of the fraud, he could not avoid complicity in the fraud unless he did blow the whistle, though this we needn't decide. He did not even wash his hands of the business by walking away, but instead watched contentedly as money was diverted from other loans that he knew to be a fraud on the bank of which he was a stockholder to pay interest on his fraudulent loan, the loan to Neuport Estates. The Neuport Estates enterprise was ongoing, moreover; it was not a completed fraud that preceded the broader conspiracy in which Sullivan is alleged to have participated. Sullivan joined the larger conspiracy when, having helped to launch it, he knowingly permitted it to nourish his own particular fraud.

As in *Santee v. Day*, we have not a case of "mere knowledge, acquiescence, or approval, without intentional participation," which is "not enough to constitute one a party to a conspiracy," *Aaron v. Dausch*, 313 Ill. App. 524, 535, 40 N.E. 805, 810 (1942), but instead a case governed by the rule "that all persons who aid or advise in the commission of a fraudulent act by another, *or who approve of it after it is done for their benefit* are liable in the same manner as they would be had they themselves performed the same act," *id.* at 530, 40 N.E.2d at 808 (emphasis added). See also *Egan v. United States*, 137 F.2d 369, 378 (8th Cir. 1943). Suppose, to vary the facts immaterially, that a group of people got together and agreed to distribute illegal drugs in Chicago, and each took shares in the enterprise. The enterprise spread to other cities, resulting in increased revenues for the Chicago operation, and a member of the original group, who knew about but did not participate in the expansion, obtained some of the increased revenues by virtue of his share in the Chicago branch. He would be a member of the larger conspiracy, cf. *Old Security Life Ins. Co. v. Continental Illinois National Bank & Trust Co.*, 740 F.2d 1384, 1397 (7th Cir. 1984), and this case is the same. We hold that under Illinois law one who participates actively in launching a conspiracy with limited aims, who knows that the aims have been exceeded, and who knowingly obtains direct monetary benefits from the expanded conspiracy, is a participant in that conspiracy as well as the narrower one from which it grew. He has joined the broader conspiracy and his liability grows with it.

A couple of loose ends, and we are done. The first is, what to do about Sullivan's set off against Hartford's claim? Remember that Judge Leighton dismissed Sullivan's counterclaim, and Sullivan did not file a conditional cross-appeal, as he could have done, in order to preserve the set off in the event that his suit against Ford City Bank failed, as it has. An appellee who wants the judgment of the district court modified, as distinct from merely wanting to defend the district court's judgment on a

ground ignored or rejected by the district judge, must file a cross-appeal; for the application of this rule in the context of a set off see *Ayers v. United States*, 750 F.2d 449, 457 (5th Cir. 1985). Whether the rule is jurisdictional is a debated topic. See 15 Wright, Miller & Cooper, Federal Practice and Procedure § 3904 (1976). Whether it even applies to a case such as the present where the modification is conditional on the appellate court's rejecting other parts of the district court's decision is a question on which we can find no authority. But we need not penetrate any deeper into this thicket. Sullivan has not mentioned the set off in his brief in this court, and by his silence has waived any objection to the dismissal of the set off by the district court. Indeed, he asks us to affirm the district court's decision "in its entirety," with no ifs, ands, or buts.

Finally, we were astonished to learn at argument that disciplinary proceedings had never been initiated against Sullivan and that he remains to this day a lawyer in good standing in the Illinois bar, continuing to practice real estate law. Yet the trial of this case revealed acknowledged and very serious fraud on his part, for which he might well have been prosecuted criminally although he was not. (The other three conspirators pleaded guilty to federal criminal charges.) And this has been known for many years. We are mailing this opinion to the Illinois Attorney Registration and Disciplinary Commission for such disciplinary action against Sullivan as the Commission may deem appropriate.

The judgment against the Ford City Bank is vacated with directions to dismiss Sullivan's claim against it for lack of federal jurisdiction. The judgment against the Hartford Accident and Indemnity Company is reversed with directions to enter judgment on liability in its favor and to conduct such further proceedings as may be necessary to determine its damages. In view of our conclusion that Sullivan is liable as a conspirator, Hartford's claim based on his personal guarantee is moot.

REVERSED WITH DIRECTIONS.

A true Copy:
Teste:

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*Clerk of the United States Court of Appeals for the Seventh Circuit*

JUDGMENT—ORAL ARGUMENT

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

April 28, 1988.

Before

Hon. RICHARD A. POSNER, *Circuit Judge*
Hon. JOHN L. COFFEY, *Circuit Judge*
Hon. FRANK H. EASTERBROOK, *Circuit Judge*

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Nos. 87-1784 and 87-1843

HARTFORD ACCIDENT AND INDEMNITY COMPANY,

*Plaintiff,*

vs.

MICHAEL SULLIVAN,

*Defendant-Third-Party Plaintiff-Appellee,*

vs.

FORD CITY BANK,

*Third-Party Defendant-Appellant.*

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Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 76 C 3319—Judge George Leighton.

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This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment against Ford City Bank is VACATED with directions to dismiss Sullivan's claim against it for lack of federal jurisdiction. The judgment against the Hartford Accident and Indemnity Company is REVERSED with directions to enter judgment on liability in its favor and to conduct such further proceedings as may be necessary to determine its damages. The foregoing is in accordance with the opinion of this Court entered this date. Costs on both of these appeals are assessed against the defendant-third-party plaintiff-appellant-appellee, Michael Sullivan.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

May 12, 1988.

By the Court:

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Nos. 87-1784 and 87-1843

HARTFORD ACCIDENT AND INDEMNITY COMPANY,

*Plaintiff,*

vs.

MICHAEL SULLIVAN,

*Defendant-Third-Party Plaintiff-Appellee,*

vs.

FORD CITY BANK,

*Third-Party Defendant-Appellant.*

---

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 76 C 3319—Judge George Leighton.

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On consideration of the "EMERGENCY MOTION FOR EXTENSION OF TIME IN WHICH TO FILE A PETITION FOR REHEARING" filed herein by counsel for appellee Michael Sullivan on May 11, 1988,

IT IS ORDERED that said motion is GRANTED. The petition for rehearing of the defendant-third party appellee will be due on or before June 2, 1988.

[ENTERED JULY 6, 1988]

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

July 6, 1988.

Before

Hon. RICHARD A. POSNER, *Circuit Judge*
Hon. JOHN L. COFFEY, *Circuit Judge*
Hon. FRANK H. EASTERBROOK, *Circuit Judge*

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Nos. 87-1784 and 87-1843

HARTFORD ACCIDENT AND INDEMNITY COMPANY,
*Plaintiff-Appellant,*

v.

MICHAEL SULLIVAN,
*Defendant-Third-Party Plaintiff-Appellee,*

v.

FORD CITY BANK,
*Third-Party Defendant-Appellant.*

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Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 76 C 3319—George N. Leighton, *Judge.*

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## ORDER

On June 2, 1988 plaintiff-appellee filed a petition for rehearing with suggestion for rehearing en banc. All of the judges on the original panel have voted to deny the petition, and none of the active judges has requested a vote on the suggestion for rehearing en banc. The petition is therefore DENIED.

[Dated May 27, 1983]
IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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HARTFORD ACCIDENT & INDEMNITY CO.,

Plaintiff,

vs.

BRUCE BEEDE, et al.,

Defendants.

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MICHAEL SULLIVAN,

Counter-Plaintiff,

vs.

HARTFORD ACCIDENT & INDEMNITY,

Counter-Defendant.

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MICHAEL SULLIVAN,

Third Party Plaintiff,

vs.

FORD CITY BANK,

Third Party Defendant.

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Before the Honorable George N. Leighton
United States District Judge

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## MEMORANDUM

This is a civil action by an insurance company, as an assignee, to recover for losses incurred by a bank to which the company had issued blanked bankers' bonds. It is alleged in Count I of the complaint that four individuals engaged in a conspiracy to convert various sums of money through unauthorized loans from the bank. In Count IV, a claim is made seeking recovery on a guaranty of $250,000 loan. Jurisdiction of this court rests on the diversity of citizenship of the parties.

One defendant defaulted, a judgment was entered against him. Two others settled with the plaintiff, they entered into a covenant not to sue. The remaining defendant, a lawyer and member of the bar of this court, has answered the complaint and denies all of its material allegations. In addition, he has filed a counterclaim and third party complaint against the insured bank claiming conduct that constituted breaches of trust and other wrongs. The cause has been tried to the court without a jury, only as to the claims against and by the lawyer. Evidence consisting of the testimony of witnesses and exhibits has been heard; proposed findings of fact and conclusions of law have been submitted by the parties; oral and written arguments have been considered by the court. The following are the material facts.

### I.

The plaintiff, Hartford Accident and Indemnity Company, is a Connecticut corporation which insured Ford City Bank in Chicago, under various bankers' blanket bonds. It brings this action as an assignee of the bank against William Quinn, Bruce Beede, Richard Orlak, and Michael Sullivan. Beede defaulted, a $1,275,000 judgment was entered; Quinn and Orlak settled. Sullivan is the only defendant now before the court; he is an attorney who, during the period relevant to this controversy, practiced law and represented individuals who were customers of the bank. The bank in question is the Ford City Bank, the third party defendant, an Illinois banking corporation with its place of business in Chicago, Illinois.

The relevant portion of Hartford's complaint is in two of four counts. Count I alleges a conspiracy to defraud Ford City Bank, with Sullivan said to have been a participant. Count IV is on the guaranty of a $250,000 loan signed by Orlak and Sullivan, guaranteeing loans made to Ford City Bank Trust 300, an Illinois land trust of which he was one of two beneficiaries. Sullivan counterclaims in three counts against Hartford as assignee, and has filed a third party complaint against the Ford City Bank. Count I of the latter pleading alleges a breach of fiduciary duty, Count II alleges conversion, and Count III alleges that Ford City committed fraud in its dealings with Sullivan.

The events which give rise to this case occurred during the years 1970 through 1974. Ford City Bank made loans secured by real estate. William Quinn was its vice president, and head of its commercial loan department. His responsibilities at Ford City included business development. This is to say, he was responsible for obtaining depositors who deposited their money in the bank, and he had the responsibility of finding borrowers who would borrow funds from the bank. Bruce Beede was the bank's loan officer in that department. Richard Orlak was a construction contractor. Michael Sullivan practiced law in the Chicago metropolitan area. He was also a real estate broker, owner of Sullivan Realty Co., a real estate brokerage firm; and a specialist in real estate law. During the relevant years, he represented contractors and developers involved in purchasing real estate, subdividing land, developing condominiums and townhouses; he represented buyers and sellers. During the years 1972 through 1974 alone, he closed 650 condominium unit sales with a total purchase price in excess of $16 million.

John Wheeler was President of Ford City Bank. In this position, he was a member of the bank's executive committee which had three members. The committee's functions were to review all loans made by the bank's loan officers, approve or reject proposed loans which exceeded loan officers' lending authority. The committee required

loan officers who proposed loans in excess of their lending authority to prepare and submit a written proposal. It was the loan officers' responsibility to include on such a proposal all relevant information concerning the proposed loan. This would include the name of the borrower, his credit history, the terms of the loan, the collateral for it, the value of the collateral, and any other relevant information which would reasonably affect the committee's judgment on whether to approve the loan.

The executive committee considered the prior bankruptcy of a proposed borrower a factor which could affect their judgment on whether to approve a proposed commercial loan; accordingly, it was the responsibility of the proposing loan officer to disclose any prior bankruptcy of a potential commercial borrower. Consistent with this policy, Ford City Bank required potential borrowers to complete and submit applications for credit which required the borrower to disclose any prior bankruptcy experience. During the period 1970-1974, the executive committee never approved a commercial loan to a borrower whom it knew had previously declared bankruptcy.

Wheeler and the executive committee also considered whether the loan officer proposing a commercial loan had an ownership interest in the project to which the loan related. Indeed, it was, or could be, an extremely relevant factor. Pursuant to both Ford City's policy and the provisions of the Illinois Banking Act, any loan in excess of $5,000 made to a loan officer had to be approved by the bank's board of directors before the loan proceeds were disbursed. This required prior disclosure to the board, by a loan officer, of his interest in a project to which a loan related. In fact, Wheeler, the other members of the executive committee, Quinn, and Beede, all knew that it constituted a conflict of interest contrary to bank policy for a loan officer to be a partner or joint venturer of a borrower on a project being financed by the bank. Moreover, it was Ford City's policy not to lend more than 75% of the purchase price of vacant property, or of the appraised value of the property, whichever was less.

Throughout the period relevant to this controversy, Sullivan was Orlak's attorney. Prior to February, 1970, Sullivan represented Orlak in connection with various partnerships in which Orlak had an interest. He also represented him in connection with the purchase of several lots in Justice, Illinois and Palos, Illinois and in connection with the sale of several homes in Hickory Hills, Illinois. Sullivan, however, did not own any interest in these partnerships, or other Orlak projects. He was only Orlak's lawyer.

Sullivan continued to represent Orlak throughout the years 1970 through 1974. In 1973, Sullivan's law firm incorporated Orlak Construction Company, with Orlak the sole shareholder. Sullivan was the Secretary of the company. During 1973 and 1974, Sullivan represented Orlak in connection with development of a 42 unit condominium complex in Justice, Illinois known as Indian Plaines. At the same time, Orlak was developing a piece of property in Palos, Illinois known as Carlton Subdivision, and Sullivan was his attorney with respect to that project. In 1972, Sullivan sold a parcel of real estate to Orlak. The financing for this sale was provided by Ford City Bank.

During the years relevant to this controversy, Sullivan referred substantial business to Quinn and the Ford City Bank. He sent to Quinn persons who borrowed millions of dollars from the bank. Sullivan also referred contractors and subcontractors who deposited in excess of $14 million in checking accounts at the bank. All of these customers were sent by Sullivan directly to Quinn. And, during the same period, Quinn referred legal business to Sullivan. When he had the opportunity, Quinn would advise bank customers and others that Sullivan specialized in real estate law. Quinn recommended that bank customers retain Sullivan to handle their legal affairs.

In February, 1970, Orlak needed a $6,000 loan; he could not obtain one from any bank because of his poor credit history, including his prior bankruptcy. Orlak asked Sullivan to help him; Sullivan knew that Orlak had, in 1962, declared bankruptcy; he brought Orlak to Ford City Bank and introduced him to Quinn. Sullivan recommended that

Quinn approve a $6,000 loan to Orlak. Prior to this, Ford City Bank had never loaned Orlak any money. Quinn agreed and assigned Orlak's account to Beede. Orlak, as he was required to, submitted an application for credit on a form provided by Ford City. Orlak signed and submitted the application, dated February 27, 1972. The application requested that Orlak disclose all bankruptcy proceedings in which he had been involved; he did not list his prior bankruptcy and thereby concealed that fact from the bank.

From the first loan in February, 1970 through the summer of 1972, Beede approved many additional loans to Orlak or to Illinois land trusts of which Orlak was a beneficiary. Orlak personally applied to the bank for these loans; Sullivan neither recommended them nor had any part in their being applied for or processed at the bank. Beede and Quinn proposed and recommended these loans to the bank's executive committee. Sullivan never sought nor urged these decisions by Quinn and Beede. By the summer of 1972, Orlak's total indebtedness to Ford City Bank exceeded $500,000. Sullivan, in his capacity as Orlak's lawyer, learned of the fact that Ford City was granting loans in substantial sums of money to Orlak. In one transaction in 1972, for example, Sullivan sold a piece of property to Orlak, and Ford City Bank provided the financing. Orlak, with the loans from Ford City approved or proposed by Beede and Quinn, went into the general contracting business. Some of the loan proceeds were used in projects he undertook as a general contractor. Sullivan was Orlak's attorney; Sullivan Realty Co. acted as broker for Orlak. Sullivan was paid fees and commissions from the Orlak projects, and from loans made by Ford City to finance those projects. During the same period through the summer of 1972, Sullivan continued to refer a substantial number of bank customers to Quinn at the Ford City Bank; Quinn continued to refer a substantial amount of legal business to Sullivan.

In the summer of 1972, a parcel of land later known as Neuport Estates was for sale at the price of $190,000.

It was unimproved, unsubdivided, consisting of approximately 17 acres. Orlak became interested in purchasing the land; but he did not have the money to do so. He spoke with Beede and told him that Neuport Estates would be a good investment. Orlak invited Beede to be a partner or joint venturer in the project. He also told Beede that Quinn and Sullivan were being invited to become additional partners in the venture. Orlak told Beede that he (Orlak) was inviting Beede, Quinn and Sullivan to be his partners because he appreciated what they had done for him. Shortly thereafter, Beede talked with Quinn, telling him that Orlak wanted to purchase and develop Neuport Estates with Sullivan, Quinn, and Beede as his partners. Beede said that Orlak was doing this because he appreciated what the other three had done for him. Beede and Quinn subsequently drove to Neuport Estates and inspected it; both were impressed with the property.

In July, at about the time he spoke to Quinn and Beede, Orlak asked Sullivan to be a partner in Neuport Estates. He told Sullivan that the property could be subdivided into 54 lots; that the subdivision could be completed by the end of the year 1972; and that the lots could be sold at a substantial profit. Orlak told Sullivan he needed a partner or partners because he, Orlak, could not qualify for a loan to purchase the property. Orlak and Sullivan then inspected the property. Quinn then asked Beede to arrange a meeting of the four prospective partners. Beede contacted Orlak who contacted Sullivan. The four agreed to meet at Beede's home in Palos, Illinois on a Saturday morning.

Sullivan, Orlak, Quinn and Beede met at Beede's home in Palos, Illinois on a Saturday morning in the late summer or early fall of 1972. They discussed Neuport Estates and an arrangement by which each would be an equal partner or venturer in the development of the parcel. At the end of the meeting, it was understood that Sullivan and Orlak would apply for a Ford City loan of $235,000 to be used, in part, for the purchase and subdivision of

the property. Quinn and Beede were to recommend approval of the loan by the bank's executive committee. It was generally understood by the four men that, to the extent Beede and Quinn had any interest in the project, it would be concealed from the Ford City's executive committee. They agreed about how title to the property would be held: an Illinois land trust would be formed with Sullivan and Orlak as the disclosed beneficiaries. As to the project's development, it was understood by the four that after Neuport Estates was acquired, it would be subdivided into 54 lots, all prior to the end of 1972. The lots would then be sold and the profits divided among the parties. There was mention made by Sullivan (the only lawyer among them) that, when profits were realized, a corporation could be formed; Beede and Quinn would be shareholders; their profits could be funneled through the corporation. Orlak estimated that approximately $300,000 could be made from the project. All of the funds required for the development would be loaned by Ford City Bank; none of the four would contribute any money.

At this meeting, Quinn and Beede emphasized the importance of their interest in Neuport Estates being concealed. Quinn explained that he would be fired from the bank for conflict of interest if it became known that he was a partner in the project. The only subject discussed at the meeting was Neuport Estates and the prospective loan concerning it. Orlak did not mention any of his other loans, or plans therefor; neither Quinn nor Beede said anything about other loans to Orlak from Ford City Bank.

Shortly after the meeting, Sullivan and Orlak applied for a $235,000 Neuport Estates loan at the Ford City Bank. Sullivan was, at the time, a borrower from the bank, and a guarantor of loans exceeding $800,000, all paid on time. Therefore, he had an established credit reputation. The interest to be paid was the prevailing rate. Orlak signed and submitted a financial statement dated August 25, 1972; it misrepresented that he had never, "taken bankruptcy." And, as the four had discussed in Beede's home, Ford City Bank Land Trust No. 300 was

set up for the purpose of taking title to Neuport Estates; Sullivan and Orlak were the disclosed beneficiaries.

At or about the time that Sullivan and Orlak applied for the loan, Beede requested and obtained a written appraisal of Neuport Estates. It was "subject to" the property being subdivided into 54 lots and improved with streets, curbs, gutters and sewers. In fact, at the time of the appraisal, Neuport Estates was subdivided and was not improved in any way; further, the cost of subdividing and improving the property was estimated by Orlak to be at least $270,000. The appraiser expressed the opinion that the property, subdivided and improved, would be worth $540,000. Using this appraisal, Quinn and Beede, in a loan proposal, recommended to the bank's executive committee that Trust No. 300 be loaned $250,000 for the purpose of acquiring Neuport Estates. The proposal did not disclose that Quinn and Beede were interested in the profits from Neuport Estates. It stated that Neuport Estates had been appraised at $540,000; it did not make clear that the appraisal figure depended on the property being subdivided and improved with streets, curbs and gutters. In fact, at the time of the loan proposal, the property was unsubdivided and had no improvements on it. The purchase price of the land, that is, $190,000, was not disclosed. Neither Beede nor Quinn told the executive committee that Orlak, a guarantor of the proposed loan, had declared bankruptcy in 1962. They did not reveal that the purchase price of Neuport Estates was only $190,000 and that the loan they were recommending was over 130% of that purchase price. The loan was approved in the sum of $250,000 to Trust No. 300 for the express purpose of providing funds for acquisition of Neuport Estates. In doing so, the executive committee relied on the loan proposal representations and the recommendations of Beede and Quinn.

Closing of the Neuport Estates purchase took place on two dates: November 2, 1972 and January 12, 1973. On the first date, the sellers executed a deed conveying the land to Trust No. 300. Ford City Bank paid some of the

proceeds of the loan to the sellers as part of the purchase price. Ford City, as trustee of Trust No. 300, signed a promissory note to Ford City in the sum of $250,000. Sullivan and Orlak signed a guaranty, prepared by the bank, which guaranteed payment of the $250,000 loan and "all obligations of the Debtor [Trust No. 300] to the bank, howsoever created, arising or evidenced, with the direct or indirect, absolute or contingent, or now or hereafter existing, or due to become due * * *." The maximum liability under the Guaranty was $250,000. On the same day, and as security for the loan, Sullivan and Orlak signed a document, also prepared by the bank, entitled "Collateral Assignment of Beneficial Interest". It contained the statement that Trust No. 300 was being assigned as collateral for the $250,000 loan "or any other indebtedness whether by way of renewal, extension, future advances or otherwise, direct or indirect, due or to become due from the undersigned, or any of them, and howsoever or whensoever created, arising, acquired or evidenced to the aforesaid bank, . . ."

On the date of the second closing, January 12, 1973, Ford City Bank, on Quinn and Beede's recommendation, increased the $250,000 loan to $270,000, and disbursed the proceeds. The sum of $190,000, earlier partly distributed at the first closing, was used to pay the sellers for the land; the balance was used for diverse purposes, some unrelated to development of the property. No closing statement from Ford City Bank itemizing its disbursements of the proceeds of the loan was ever issued. Sullivan, a lawyer experienced in real estate loan closings, never asked for such a statement.

Sometime in December 1972, shortly after the first phase of the closing, Beede told Quinn that he had received a new appraisal of Neuport Estates which indicated that the property had a value higher than originally thought. Beede said that the loan could be increased based on that appraisal, and from this increase he, Quinn, Sullivan and Orlak could each receive $10,000 in cash. Beede told Quinn that Orlak and Sullivan had agreed to that distribution and receipt of the cash. During the first several months

of 1973, Quinn, on three occasions, was given a sealed envelope by Beede. Each contained $100 bills; the total sum was $10,000. When Quinn received the third envelope, he asked Beede if "everybody was square?" Beede replied that each of them had received their share. The $10,000 in cash received by Quinn were not proceeds of the loan approved by the bank's executive committee for acquisition of Neuport Estates. These were monies from proceeds of other loans made by the bank to Orlak. Quinn had no personal knowledge of Sullivan's part in the payment of these monies. At no time did he ever discuss his receipt of these monies with Sullivan. He spent only $100 of the $10,000 in cash he received. In June 1974, at about the time he disclosed to Wheeler the bank president the existence of his secret interest in Neuport Estates, he returned $9,900 in cash to Wheeler. At the same time, he made statements to Wheeler which inferred that Beede had received cash, checks, or both from proceeds of loans made by Ford City Bank to Orlak or Illinois land trusts he controlled. Quinn did not tell Wheeler that he had personal knowledge of any act or conduct of Sullivan concerning payments of these monies.

On or about December 19, 1972, Orlak received four Ford City Bank cashier's checks, each in the amount of $2,000. He cashed the checks at the bank and used the proceeds to purchase Christmas presents. The source of the checks was the loan which had been approved by the bank's executive committee for the purpose of acquiring Neuport Estates. On or about March 9, 1973, Orlak received a Ford City Bank cashier's check in the sum of $5,000; he cashed it at the bank. On or about March 27 he received another cashier's check, also of the bank, in the amount of $6,000 which he cashed there. Source of both checks was the loan approved by the bank for the purpose of acquiring Neuport Estates.

In February 1973, Sullivan was at Ford City Bank for a real estate closing; he walked by Beede's desk. Beede handed him a sealed envelope which Sullivan put in his pocket. Later in his office he opened the envelope and

inside were $4,000 in crisp new $50 bills. Sullivan called Orlak. The $4,000 were not proceeds of the loan which the bank's executive committee had approved for purchase of Neuport Estates; they were proceeds of some other loan made by the bank to Orlak. Several weeks later, still in February 1973, Sullivan was again at the Ford City Bank for a closing. He walked by Beede's desk and again Beede handed him a sealed evelope. After returning to his office, he opened the envelope and found an additional $4,000 in $50 bills. Sullivan then called Orlak. These $4,000, like the first, were not proceeds of the loan approved for acquisition of Neuport Estates. They were monies from some other loan made by the bank to Orlak. Sullivan made no attempt to discuss either with Wheeler the bank president or any director or officer at Ford City about his receipt of the $8,000 in cash. He knew that the receipt of this money, and the circumstances surrounding it, were highly unusual. He used the $8,000 in cash for personal items; he believed the money was part of the proceeds of the $250,000 Neuport Estates loan.

In April 1973, Sullivan received through the mails a Ford City Bank cashier's check in the sum of $9,303.71. There was no cover letter from the bank with the check; nor was there any explanatory document with it. Sullivan had not billed the bank for any legal service rendered. The source of the check was the loan which the bank had approved for the purpose of Neuport Estates. Sullivan deposited the check in his Sullivan Realty Company account and subsequently used the proceeds to pay costs incurred in Orlak's development of the Indian Plaines project. He made no attempt to discuss either with Wheeler the bank president or any director or officers of Ford City Bank his receipt of the cashier's check. Sullivan knew that his receipt of the check was unusual and irregular.

Beginning on or about February 27, 1970 and continuing to June 19, 1974, William Quinn and Bruce Beede were officers and employees of Ford City Bank. Quinn, among his other duties, was Sullivan's loan officer, Beede was Orlak's. Sullivan, as a practicing attorney, was Orlak's

lawyer in many real estate projects. In some instances, he acted as real estate broker for Orlak; his fees and commissions were paid by Orlak from funds borrowed not only from Ford City Bank, but from other banks. In the instances when Ford City financed a project for Orlak, Quinn, Beede, or both of them, acted for the bank in the loan transactions. In every instance, but the Neuport Estates transaction, Sullivan's only role was that of a lawyer representing Orlak. In every case or transaction for which he was paid a fee or commission, he earned the money he was paid.

After the Neuport Estates loan transaction of November 2, 1972, the $250,000 loan to Trust No. 300, Beede and Quinn, at Orlak's request, and on his sole application, or for partnerships with persons other than Sullivan, approved and recommended twenty (20) loans on various dates between December 22, 1972 and the end of April, 1974. Sullivan was never told of the loans by Quinn or Beede, nor did he have any part either in the application for or the approval of these loans:

(a) December 22, 1972, in the sum of $217,367.84. The Matteson-Richton Bank participated to the extent of $43,789.82. The represented purpose of this financing was to improve Neuport Estates; but the proceeds were not so used. With Quinn and Beede's knowledge and approval, proceeds were used to pay off other Orlak loans at Ford City so that Beede and Quinn could falsely represent to the bank's board of directors, and its executive committee, that Orlak was current in his other loans.

(b) November 21, 1973, $250,000, with two other banks participating. The proceeds of this loan were disbursed with Beede and Quinn's knowledge, for purposes other than those represented to the bank at the time loan approval was obtained.

(c) April 12, 1974, $192,000 for the ostensible purpose of constructing single family residences on lots 5, 6 and 8 in Neuport Estates. In connection with this

loan, made in excess of lending limits, Beede misrepresented Orlak's credit condition; he violated a letter of agreement between Ford City and the First National Bank of Oak Park. Beede misrepresented the ownership status of lots 5, 6 and 8 in Neuport Estates.

(d) April 10, 1974, in the sum of $76,000 for the ostensible purpose of improving Lot 7 in Neuport Estates. The loan was in excess of Beede's lending limits; without authority he entered into a disbursing agency agreement with another bank. The proceeds were disbursed for purposes other than construction improvement of Lot 7. Beede misrepresented Orlak's credit condition to the participating bank and authorized disbursement of the loan without sworn contractor's affidavits and mechanic lien waivers.

(e) February 1, 1973, five loans totaling $1,134,000, purportedly for the construction of condominiums in a project known as Indian Plaines Townhouses. Sullivan represented Orlak in the sales of the condominiums; his fee was $300 per closing; he was Orlak's real estate agent or broker. Sixty-five percent of the loan proceeds were paid directly to Orlak's construction company, with the consent of Beede and Quinn without sworn contractor's affidavits or proper waivers from subcontractors. Proceeds of the loan were used to reduce land loans on the property rather than for construction; deficits on the loan account were concealed from the bank's board of directors; and at about that time, Beede and Quinn each received $10,000 from proceeds of the Neuport Estates loan.

(f) May 14, 1973, in the amount of $133,000. This loan was recommended without an approved proposal, and was to Ford City Bank Trust No. 465, an Orlak land trust. The proceeds were purportedly to acquire and unsubdivide land located in Palos Hills, Illinois known as the Orlak Hills Subdivision. Orlak

was the sole beneficiary of Trust No. 465. The loan was in excess of the purchase price; no appraisal of the land's value was made except an arbitrary value placed in the loan file and initialed by Beede. $10,000 of the loan proceeds were received by Orlak with Beede's approval. A portion of the loan was used to pay off an existing earnest money loan to Orlak.

(g) April, 1974, Beede, acting without authority, requested First National Bank of Oak Lawn to lend money to Orlak, with Ford City acting as disbursing agent, for land improvements and construction of single family homes on Lots 2, 4, 5 and 6 in Orlak Hills Subdivision. Pursuant to this request, First National Bank of Oak Lawn disbursed $253,600 of the Orlak loans to Ford City as disbursing agent. Beede caused Ford City Bank to suffer a loss of $112,089.50 from these loan proceeds. He did not have authority to request these loans be made; they exceeded his lending limits; he misrepresented the loan credit status of Orlak to the First National Bank of Oak Lawn; no improvements were made on the properties; and, as a result, the credit position of Orlak was concealed from the board of directors of Ford City.

(h) November 19, 1973, Beede authorized an installment loan to Orlak for the ostensible purpose of constructing a single-family residence at 10359 South 89th Avenue in Palos Hills, Illinois. The loan was without the approval or authority of Beede's superiors at Ford City; a portion of the loan, $9,068 was used to pay other loans of Orlak at the bank; the balance was deposited in the Orlak Construction Company account without a sworn contractor's affidavit. There were no mechanic lien waivers; the proceeds were used to pay other unrelated loans of Orlak in order to conceal his true credit condition from the directors of Ford City.

(i) August 8, 1973, in the sum of $340,680.78. This loan was to enable Orlak to purchase a parcel of commercial property. The proceeds, in fact, were used to pay off prior existing land loans. $20,000 of the proceeds were issued directly to Orlak in the form of cashier's checks which were negotiated at Ford City with Beede's approval.

(j) August 28, in the sum of $374,839.58. $342,823.78 of these proceeds were used to pay off the August 8 loan. A portion, $12,015.80, was used to pay off another unrelated loan of Orlak's, thereby concealing his true financial condition from the board of directors of Ford City. $20,000 were issued in Ford City Bank's cashier's checks and negotiated by Orlak at the Bank, with Beede's approval.

(k) July 30, 1973, five loans for the construction of five single-family dwellings in Carlton Subdivision in Palos Hills, Illinois, each loan in the amount of $30,600. The proceeds were paid directly to Orlak Construction Company without sworn contractor's affidavits or mechanic lien waivers. No provision was made in any of the loans for reduction of an underlying land loan in the amount of $80,000. Proceeds were used to pay off existing unsecured loans of Orlak, thereby concealing his true credit condition from the directors of Ford City. The loan proceeds were exhausted without completion of the buildings; neither Beede nor Quinn notified the board of directors of Ford City that these proceeds had been exhausted.

(l) November 19, 1973, five construction loans in order that Orlak could build five single-family homes for resale on Lots 1 and 2 of Orlak's subdivision and Lots 1, 4 and 5 in Indian Plaines Subdivision. Each loan was in the sum of $36,000. Payments from these loans were made directly to Orlak Construction Company without submission of sworn contractor's affidavits or mechanic lien waivers. Proceeds

were used to pay off existing unsecured and installment loans of Orlak, thereby concealing his credit problems from the board of directors of Ford City.

In none of these twenty (20) loans did Sullivan seek, recommend, urge, or in any way procure them for Orlak. Sullivan did not, in any way, solicit, urge, or procure the conduct of Quinn or Beede in any way in connection with any of these loans.

Between November 2, 1972, the date of the Neuport Estates loan and June 19, 1974 when Ford City Bank officials discovered the unauthorized and irregular loans Beede and Quinn had approved, Orlak defaulted on all of his loans from Ford City. They totaled, exclusive of the Neuport Estates loan, in the principal amount, the sum of $2,524,847.50. The defaults were foreordained. During the year 1973, Orlak experienced financial difficulties. He was not able to get Neuport Estates subdivided until August 31, 1972; and, when it was subdivided, only 45 lots were produced. Sullivan, as Orlak's lawyer generally, and partner in Neuport Estates, knew of Orlak's financial problems and was specifically aware of the delay in getting Neuport Estates subdivided. He knew that when the subdivision plat was finally approved, there were only 45 lots, rather than the 54 originally planned. When Neuport Estates was subdivided, Sullivan and Orlak estimated the cost of improvements such as streets, curbs, gutters, and sewers, at approximately $270,000. Sullivan asked Beede to approve and recommend to Ford City's executive committee a loan in that amount; Beede agreed to do so.

On or about October 24, 1973, Sullivan and Orlak each signed separate letters of direction authorizing Ford City Bank as trustee under Trust No. 300 to sign a note for $270,000 evidencing "an improvement loan." Sullivan told Beede that the proceeds of the loan were not to be disbursed without his authorization. During the year 1973, Orlak used funds he borrowed from Ford City to pay interest on the original $250,000 Neuport Estates loan. Sullivan knew that Orlak was using funds from other Ford

City Bank loans to pay interest which had been approved for the acquisition of Neuport Estates. Sullivan did nothing to bring to the attention of Wheeler, the bank president, or that of any other director or officer of the bank concerning these facts. Sullivan at that time was both a substantial shareholder of Ford City Bank, and was a lawyer constantly in touch with the bank in connection with loan closings for clients he represented, including Orlak. From September 1, 1973 through January, 1974, Orlak made substantial improvements in Neuport Estates; at least 40-50% of the improvements were completed and Sullivan knew that this work was being done. Despite his instructions to Beede, Sullivan never gave written authorization to disburse the proceeds of the $270,000 improvement loan. He knew, or was of the opinion that, from the period September, 1973 through January, 1974, monies were used to pay for improvements in Neuport Estates from other loans which Orlak obtained from Ford City Bank. Sullivan knew that these loans had been approved for purposes other than Neuport Estates construction of improvements; and that such loans were being misapplied and used for other than their intended purpose. Sullivan never made any attempt to discuss the improper use of loan proceeds in putting improvements in Neuport Estates with either Wheeler or any director or officer of Ford City Bank.

Among the financial difficulties Orlak experienced in 1973 were those in connection with his Indian Plaines project. Sullivan knew of these; he had received an opinion letter from a title company stating that Indian Plaines was "landlocked," it had no access to a public street. Sullivan knew that Beede and Quinn had approved, and Ford City Bank had made, a $1,100,000 loan to Orlak on the Indian Plaines project. Sullivan did not attempt to discuss Orlak's problems with this project either with Wheeler or any other director or officer of the bank.

As a consequence of these difficulties, Orlak was not able to pay his Ford City Bank loans as they became due. When Quinn and Beede became aware of this fact, they

renewed the loans, thereby concealing from Ford City Bank's executive committee Orlak's financial problems. As Orlak's lawyer and a partner with him in Neuport Estates, Sullivan knew what was occurring with regard to Orlak's financial condition during 1973; but he never discussed this matter either with Wheeler or any other director or officer of the bank. Throughout the year 1973, there were numerous illegalities and irregularities in connection with loans to Orlak approved by Quinn and Beede and made by Ford City Bank. Some loans were granted for one purpose but the proceeds were diverted and used for others; proceeds of loans made for other projects were diverted and used to put improvements in Neuport Estates and to pay interest on the loan which had been approved to acquire that land. Proceeds of loans to Orlak made for other projects were used to make cash payments of at least $8,000 to Sullivan, $10,000 to Quinn, and an unknown amount to Beede. In other instances, construction loan proceeds were disbursed without required documentation, that is, contractor's affidavits, waivers of liens, and other required papers. Large amounts of monies, with the approval of Quinn and Beede, were disbursed directly to Orlak; none of these illegalities and irregularities were discovered by Wheeler, the bank president, or by any officer or director of Ford City Bank until June, 1974. In September, 1973, Wheeler had become concerned about Orlak's outstanding loans; he issued a directive prohibiting additional loans to Orlak. Beede and Quinn violated this directive.

In November, 1973, Sullivan signed a letter of direction in blank, and gave it to Beede. Sullivan did this at Beede's request; he signed other documents in blank and gave them to Beede. Neither Wheeler, nor any member of the executive committee nor any officer or director of Ford City Bank knew that in 1962 Orlak had declared bankruptcy. None of them knew this because it was not disclosed either by Beede, Quinn, Sullivan or Orlak. If any of these facts had been known by Wheeler, or by any director or officer of Ford City Bank, they would have fired Quinn, refused to grant additional credit to Orlak,

and would have declared as due immediately all of Orlak's outstanding loans. If Wheeler had known in January, 1973 that Orlak at one time had been a declared bankrupt, he would have refused to approve and grant additional loans to Orlak.

By January, 1974, Orlak's financial condition became more acute. Checks he had written to subcontractors were being returned for insufficient funds. He was having trouble with almost all of his projects. Sullivan knew of these; and to avoid some of them, he told Orlak to open a checking account at another bank. In the same month, Sullivan received an interest statement from Ford City relating to the Neuport Estates acquisition loan. It indicated that no interest had been charged or paid on the loan during the entire year 1973. Sullivan also reviewed an additional interest statement from the bank which stated that interest of $14,349.70 had been charged and paid on a $270,000 loan made to Trust No. 300. He thought these records were incorrect because a significant amount of interest should have been charged to the loan granted for the purchase of Neuport Estates and no interest should have accrued on the $270,000.

Sullivan knew that this was irregular and unusual. He made no attempt to discuss these interest statements either with Wheeler, or with any other director or officer of Ford City Bank. By May 1, Orlak was insolvent. On or about that date he signed and submitted to Ford City Bank a financial statement which misrepresented that he had a net worth of almost $1 million. In that portion of the statement where Orlak was asked, "Have you ever taken bankruptcy?" he answered, "No." By June of that year, 1974, Quinn became aware that Orlak could not complete construction of his projects and that Orlak was insolvent. One day in early June, Quinn called Wheeler at the latter's home. The two met and Quinn confessed that he had been stealing money from Orlak loans the bank had approved, and that Beede had been doing the same thing. He disclosed to Wheeler that the bank had large problems with the Orlak projects. He told Wheeler what

he had believed all along: that he, Beede, Sullivan and Orlak were partners in the development of Neuport Estates, each owning a 25% interest and that each had agreed to conceal the interests of the two loan officers from Ford City Bank officials. Quinn told Wheeler that each of the four partners had received $10,000 from the proceeds of one or more of Orlak's loans. A few days later, Quinn returned $9,900 in cash to Wheeler which he said was what was left of the $10,000 he had received. As of July 12, 1974, the total amount of money which Orlak individually, or the trusts of which he was the beneficiary, owed to Ford City Bank on approved loans, principal, interest and charges, was $4,674,824.41.

In an attempt to recoup these monies, Ford City Bank, in the several months that followed, obtained title to all the properties which had been collateral for loans to Orlak, and to the trusts of which he was beneficiary, including Neuport Estates. The bank then proceeded to expend substantial sums of money completing projects, rehabilitating properties, paying off mechanic liens and maintaining construction schedules. From then until August, 1977, the bank spent a minimum of $592,460.74 on these properties. Its records show expenditure of additional sums completing Orlak projects, rehabilitating and maintaining the collateral properties. These additional expenditures totaled $337,279.40. All but $10,062.43 of this sum was spent on Neuport Estates. The bank then sold the property which had been collateral for Orlak loans for the best price it could obtain. It recovered $3,546,039.89. The loss sustained by the bank totaled $1,067,443.22, not including $377,279.40 which had been expended in completing Orlak properties, rehabilitating and maintaining the projects which had been collateralized for the loans.

On September 23, 1974, on demand of Ford City Bank acting through its lawyer, Sullivan assigned to it all of his interest in Trust No. 300. Two documents were involved: one was entitled "Assignment in Lieu of Foreclosure," the other labeled "Assignment." These documents were demanded by the bank and procured from

Sullivan in the bank's attempt to minimize the losses it contemplated suffering as the result of loans made to Orlak. Before Sullivan executed these documents he consulted an attorney acquaintance and received an opinion concerning their legal significance. Because of the bank's demands, Sullivan himself drafted a substantial portion of the language contained in the "Assignment in Lieu of Foreclosure."

At the time it obtained these documents from Sullivan, Ford City Bank had access to Quinn, Beede, and its files on the loans it had made to Orlak. In addition, there were in the bank's employ the people who had processed the Orlak loans. The Guaranty and Collateral Assignment that Orlak and Sullivan signed on November 2, 1972 were in the bank's files. These security documents showed that Sullivan had never undertaken responsibility for any Orlak loan except the one for the purchase of Neuport Estates. Moreover, the bank had a policy which required the execution of an hypothecation agreement if a guarantor was to be held for all advances and future loans to another person. Sullivan had never executed such an agreement.

Despite the information available to it, information which should have reasonably led the bank and its officers to do so, the bank did not take the position that Sullivan was not liable for all of Orlak's loans, even though the bank's records and files disclosed that Sullivan did not play any part in the procurement of other Orlak loans, nor did he have any part in the conduct of Quinn and Beede recommending and approving the other loans to Orlak. Although the bank was trustee under Trust No. 300, and Sullivan was a beneficiary thereunder, Ford City Bank, acting through its officers and attorney, proceeded on the theory, and insisted, that Sullivan was responsible for all loans it had made to Orlak from November, 1972 to the end of April, 1974, loans which, including interest and charges, totaled more than $3,000,000.

Under the "Assignment in Lieu of Foreclosure" and the "Assignment," Ford City Bank was obligated to account to Sullivan for the proceeds of the sale of his interest in

Trust No. 300. Although the sale of Neuport Estates was for the benefit of Sullivan, as well as the bank, Ford City has never accounted to its beneficiary for the proceeds it acquired out of the sale of Neuport Estates.

Hartford Accident and Indemnity Co. was the insurer, and Ford City Bank was the insured on a banker's blanket bond which required Hartford to indemnify the bank for losses it sustained as a result of fraudulent or dishonest acts of its employees, acting alone or in collusion with others. On March 14, 1975, the bank submitted proofs to Hartford claiming it had lost in excess of $2 million as a result of the fraudulent and dishonest acts of Beede and Quinn, acting allegedly in collusion with Orlak and Sullivan. Later, the bank sued Hartford for nonpayment of its claim; its complaint alleged that it had sustained a loss of $2,500,000 as a result of the fraudulent and dishonest acts of Beede and Quinn, acting allegedly in collusion with Orlak and Sullivan. In July, 1976, Hartford and Ford City Bank settled the controversy between them. Hartford paid $1,275,000 to the bank. The parties executed a mutual release, and Ford City assigned all of its rights and causes of action against Sullivan, Orlak, Beede and Quinn to Hartford.

On receiving this payment, Ford City retired from its books all of the Orlak loans, including the $250,000 loan to Trust No. 300, guaranteed by Sullivan and Orlak. The loan had never been repaid, neither Sullivan or Orlak had performed their guarantee. After July, 1976, all proceeds from sales of the collaterals securing the Orlak loans, including proceeds from the sale of Neuport Estates, were applied to reduce the overall indebtedness arising from all the unpaid Orlak loans.

In Count I of the complaint in this suit, Hartford alleges that, as a director and proximate result of the acts of Quinn and Beede, who were employees and officers of Ford City Bank, in collusion with Orlak and Sullivan, Ford City sustained a loss of $1,275,000 which Hartford has paid; and that, as an assignee of the bank, it is entitled to judgment against Bruce Beede, William Quinn,

Richard Orlak and Michael Sullivan, jointly and severally, for actual damages in the sum of $1,275,000, $500,000 in punitive damages, and an award of its costs and attorney's fees. It prays for judgment accordingly.

In Count IV, Hartford claims judgment against Sullivan on the written Guaranty which he and Orlak, for valuable consideration, signed, unconditionally guaranteeing "the full and prompt payment when due of all obligations of Ford City Bank as Trustee under Trust Number 300. Hartford demands judgment against Sullivan "in the amount of $250,000, plus interest, together with reasonable expenses in collecting said loans and enforcing the Guaranty, including costs and attorney's fees."

II

From these facts, three issues are presented:

1. Whether in November, 1972 and continuing until on or about the end of April, 1974, William Quinn, Bruce Beede, Richard Orlak, and Michael Sullivan engaged in a conspiracy to convert various sums of Ford City Bank money through illegal, irregular, and unauthorized loans to Orlak, approved by Quinn and Beede.

2. Whether, as claimed by plaintiff in Count VI of its complaint, Michael Sullivan is liable to the plaintiff Hartford, as assignor, on the Guaranty he and Richard Orlak signed on November 2, 1972, guaranteeing payment of the $250,000 loan made by Ford City Bank to Trust No. 300 for the acquisition of Neuport Estates.

3. Whether, as alleged in Sullivan's counterclaim and third party complaint, Ford City Bank, its officers and attorney, engaged in conduct which constituted breaches of trust and other wrongs when the assignment of Sullivan's beneficial interest in Trust No. 300, and the assignment in lieu of foreclosure, were obtained from him. In resolving these issues, the court reaches the following conclusions of law.

## III

A. *As to the alleged conspiracy.*

This is a case in which the jurisdiction of this court is based on diversity in the citizenship of the parties. Plaintiff Hartford is a Connecticut corporation; its principal place of business is in the city of Hartford in that state. Defendants Beede, Quinn, Orlak and Sullivan are citizens of Cook County, Illinois. Since Sullivan's claim against Ford City Bank, an Illinois banking corporation, arises out of the same nucleus of operative facts as does plaintiff's claims against defendants, this court has jurisdiction over the parties and subject matter of the third party complaint.

Therefore, since federal jurisdiction rests on citizenship diversity of the parties, and Illinois is the forum state, its substantive rules of law, as well as its applicable conflicts of laws decisions, are controlling. *Roberts v. Sears, Roebuck & Co.*, 471 F. Supp. 372, 378 (N.D. Ill. 1979), *vacated on other grounds*, 617 F.2d 460, *cert. denied*, 449 U.S. 975 (1980). In other words, this court must proceed as would another court of Illinois in evaluating the enforceability and viability of plaintiff's claim. *Kalmich v. Bruno*, 404 F. Supp. 57, 61 (N.D. Ill. 1975), *reversed on other grounds*, 553 F.2d 549, *cert. denied*, 434 U.S. 940 (1977).

Under Illinois law, the burden of proof in conspiracy cases always lies with the plaintiff, *Alm v. General Telephone Company of Illinois*, 27 Ill. App. 3d 876, 327 N.E.2d 523, 526 (1975); and although a conspiracy may be proved by indirect and circumstantial evidence, the proof adduced must be clear and convincing. *Bimba Mfg. Co. v. Starz Cylinder Co.*, 119 Ill. App. 2d 251, 256 N.E.2d 357; *see Bergeson v. Mullinix*, 399 Ill. 470, 78 N.E.2d 297 (1948). It is well established in Illinois that in order to constitute a civil conspiracy, there must be unlawful acts committed in its pursuit. "In a civil case, the wrongful acts alleged to have been done in pursuance of a conspiracy, and not the fact of the conspiracy itself,

is the gist of the action for damages." *Fox v. Cohen*, 84 Ill. App. 3d 744, 750, 406 N.E.2d 178, 183 (1st Dist. 1980); *Ammons v. Jet Credit Sales, Inc.*, 34 Ill. App. 2d 456, 465, 181 N.E.2d 601, 605 (1st Dist. 1962); I.L.P. Conspiracy §11. Thus, it is the rule that "[m]ere knowledge, acquiescence, or approval, without intentional participation, is not enough to render one a party to a conspiracy. *Tribune Co. v. Thompson*, 342 Ill. 503, 174 N.E. 561, 572 (1930); *Worden v. State Police Merit Board*, 30 Ill. App. 2d 323, 174 N.E.2d 407 (1961); *Aaron v. Dausch*, 313 Ill. App. 524, 40 N.E.2d 805 (1942); I.L.P. Conspiracy §12.

These principles of Illinois conspiracy law compel the conclusion that beginning in November, 1972, at Ford City Bank, there was a conspiracy whose purpose was defrauding the bank by conversion of its monies to the use of the conspirators through unauthorized, irregular, and illegal loans approved by Quinn and Beede, and made to Richard Orlak. In the course of the conspiracy, and as a direct result of it, more than $3 million in unauthorized, irregular, and illegal loans were made, causing the bank to sustain loss and damage in the sum of $1,067,433.22.

Michael Sullivan was not a member of this conspiracy. The fact that as Orlak's lawyer he knew that the loans in question were being made; that Quinn and Beede were recommending and approving loans to Orlak; and that he accepted legitimately earned fees and commissions paid from loans Orlak procured from Ford City, did not make Sullivan a member of the conspiracy by which the unauthorized, irregular, and illegal loans were procured. It is the law in Illinois that while each conspirator does not have to know the exact limits of an illegal plan, or the identity of all its participants, it is required that proof be made of a single plan, the essential nature and general scope of which was known to each person who is to be held responsible for the consequences of the alleged conspiracy. *Hoffman-LaRoche, Inc. v. Greenberg*, 447 F.2d 872, 875 (7th Cir. 1971); *Hampton v. Hanrahan*, 600 F.2d 600, 621 (7th Cir. 1979); *see Means v. City of Chicago*, 535 F. Supp. 455 (N.D. Ill. 1982).

The Neuport Estate loan which Sullivan acted with others to procure, no matter how characterized, whether as a legitimate transaction or a conspiracy, did not injure Ford City Bank. There can be no recovery for that matter, assuming it was a conspiracy, where there is no damage. *John Deere Company v. Metzler*, 51 Ill. App. 2d 340, 355, ___ N.E.2d ___ (1964); *Commercial Products Corporation v. Briegel*, 101 Ill. App. 2d 156, ___ N.E.2d ___ (1968). In fact, it was the sale of Neuport Estates for the sum of $866,500 that enabled Ford City to reduce the losses it suffered from the loans. There was a time, when the default status of Orlak was learned by Quinn, that he, on behalf of Ford City Bank, told Sullivan he believed that all of Neuport Estates, when sold, would pay for the loans on which Orlak was defaulting. Therefore, Hartford, as assignee and subrogee of Ford City, cannot recover judgment against Michael Sullivan on the theory that he was a member of the conspiracy which plaintiff in this suit alleges began in November, 1972, and whose purpose objective and intent was to defraud Ford City Bank and convert its monies to the use of the conspirators.

B. *As to the Guaranty.*

It is old, black-letter law in Illinois that a guaranty is a promise to pay a debt or perform some duty in case of the default of another person, who is liable in the first instance. *Gridley v. Capen*, 72 Ill. 11 (1874); *Rock Island Bank & Trust Co. v. Stauduhar*, 59 Ill. App. 3d 892, 375 N.E.2d 1383 (1978). Guaranty agreements are strictly construed in favor of the guarantor whose liability cannot be extended by construction. *Farmers State Bank v. Doering*, 80 Ill. App. 3d 959, 400 N.E.2d 705, 707 (1980). Moreover, where the guaranty form, and that designed "collateral assignment of beneficial interest of land trust," both signed and delivered by Richard Orlak and Michael Sullivan on November 2, 1972, were prepared and submitted by the bank in whose favor the guarantees were executed, a court will construe them in favor of the

guarantor and not extend his liability by construction. *Telegraph Sav. & Loan Ass'n. v. Guaranty Bank & Trust Co.*, 67 Ill. App. 3d 790, 385 N.E.2d 97 (1978).

Both the guaranty and the collateral assignment of November 2, 1972 are governed by these principles. It is clear that the guaranty was "in consideration of any loan or other financial accommodation heretofore or hereafter at any time made to or granted to Ford City Bank as trustee under Trust No. 300." The amount of liability was limited to the sum of $250,000, plus interest on such amount and plus all expenses of enforcing the guaranty. Since both Orlak and Sullivan executed the guarantee, liability thereunder was joint and several. *Union Oil Co. v. Maxwell*, 33 Ill. App. 421 (1889); *Isaacson's Estate v. Hertz*, 80 Ill. App. 2d 109, 225 N.E.2d 106 (1967).

For these reasons, Sullivan was, and remains, personally liable for the $250,000 loan, increased to $270,000 in April, 1973 by Ford City Bank to Trust No. 300. However, because this loan is subject to the claims of Sullivan that it should have been paid out of the proceeds from the sale of Neuport Estates, Ford City Bank cannot assign its claim for payment of the loan by Sullivan, nor can Hartford sue to recover the loan as subrogee of Ford City Bank.

C. *As to Sullivan's counterclaim and third-party complaint.*

The trust agreement dated November 1, 1972 and known as Trust Number 300, signed and delivered by Sullivan and Orlak, created what is known in Illinois law as an Illinois land trust. Comment, *Land Trustee and Secured Creditor: Fiduciary Duties Revisited*, 1982 S.Ill.L.J. 249. Although the mere fact that the trustee, Ford City Bank, became a creditor of its beneficiary can no longer be construed as a breach of its fiduciary duties; see Act of Aug. 6, 1982, Pub. Act. No. 82-891, §§1-4, 1982, Ill.Legis.Serv. 2029 (West), to be codified at Ill. Rev. Stat. ch. 148, ¶¶81-84 (1983), it is the law of Illinois that the

trustee of a land trust "has a fiduciary obligation of loyalty to the beneficiary which flows not from the trust instrument itself but from the relationship of trustee and beneficiary." *Ford City Bank, etc. v. Ford City Bank, etc.*, 110 Ill. App. 3d 123, 441 N.E.2d 1192, 1194-95 (1982). The essence of that relationship is that the trustee is charged with equitable duties toward the beneficiary; it is the law that imposes the duty, whether the trust agreement mentions it or not. *Home Federal Savings & Loan Association of Chicago v. Zarkin*, 89 Ill.2d 232, 239, 432 N.E.2d 841, 845-46 (1982).

There is sound reason in policy for holding a land trustee in Ford City's position to a strict standard of loyalty. "It is to prevent trustees from taking personal advantage of their position that the duty of loyalty is imposed." *Home Fed. Sav. & Loan Ass'n. v. Zarkin*, 89 Ill.2d 232, 432 N.E.2d 841, 848 (1982). This duty requires the land trustee to deal with the corpus of the trust only in the interest of the beneficiary; and if it becomes a creditor of its beneficiary, the trustee must always act in a way that is candid, fair, and revealing to the beneficiary all the details of transactions that lead to the sale of the trust corpus to pay the debt. Cf. *Ford City Bank, etc. v. Ford City Bank, etc.*, 110 Ill. App. 3d 123, 441 N.E.2d 1192 (1982). The trustee cannot, as to the trust property, put its interests as a creditor in a position superior to that of the debtor beneficiary.

Ford City Bank breached its fiduciary duty of loyalty to Michael Sullivan. The fact that Sullivan was a lawyer, and indeed himself experienced in handling transactions involving land trusts, is irrelevant to the application of the standard of loyalty a trustee owes a beneficiary. Ford City had access to all the facts concerning the loans made to Orlak between November, 1972 and the end of April, 1974. Its officials, including its attorney, had access to Quinn, Beede, and other bank employees who knew the details of the transactions that led to loans which, by the end of April, 1974, totaled more than $3 million. Ford City

had in its files the Guaranty and the Collateral Assignment. Its officers and attorney knew, or should have known, the terms of those security documents. Yet, they insisted that Sullivan was legally responsible for all loans the bank had made to Orlak merely because Sullivan had signed the Guaranty of November 2, 1972 and the Collateral Assignment. Plainly, Sullivan did not undertake to be responsible for all loans made to Orlak; he only guaranteed the Neuport Estates loan, and any loan made by Ford City Bank to Trust No. 300. In dealing with Sullivan as it did, Ford City placed its interests as Sullivan's creditor above its duty of fiduciary loyalty as his trustee of Trust No. 300.

From its position as a creditor, and acting solely to protect itself from losses on the loans to Orlak, Ford City Bank demanded of Sullivan that he assign in lieu of foreclosure all his interest in Trust No. 300. Even though it had no documentary support for its position, the bank insisted that Sullivan was responsible for all of the loans it had made to Orlak; it represented that Neuport Estates would be liquidated, the proceeds applied to the loans, and an accounting made of the sales. But the bank has never accounted.

It did sell a total of 45 Neuport Estates lots for $866,500. Against this gross sum were charges for interest, disbursements, and a contingency reserve, a total of $547,918.33. Thus, Ford City realized the net sum of $318,581.67. Sullivan was a 50% beneficiary of Trust No. 300, whose corpus was Neuport Estates; therefore, he was entitled to receive from the bank 50% of the net sum, or $159,290.83. Ford City Bank has never paid Sullivan the money due him from the sale of his trust interest. As a consequence, Sullivan has been damaged to the extent that the bank has withheld from him money due him from the sales which were completed on September 30, 1974. A reasonable sum to compensate him is an amount equal to the interest which the withheld sum would have earned to the date of the judgment in this case; that is, $195,000.

Therefore, Sullivan is entitled to recover from Ford City Bank the sum of $354,920.83 on this third party complaint. Sullivan is not entitled to recover on his counterclaim against Hartford. Accordingly, an appropriate judgment, in conformance with Rule 58, Fed. R. Civ. P. will be entered.

So ordered,

George N. Leighton,
United States District Judge

[DOCKETED APRIL 20, 1987]

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION
CASE NUMBER: 76 C 3319

---

HARTFORD ACCIDENT AND INDEMNITY CO.

v.

BRUCE BEEDE, et al.

---

## JUDGMENT IN A CIVIL CASE

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

Judgment be entered against the third-party defendant, Ford City Bank, and in favor of the third-party plaintiff, Michael Sullivan, in the amount of $279,714, plus a per diem rate of $51.50 interest from October 3, 1986; costs to follow the judgment as provided by law.

April 17, 1987
Date

/s/ H. Stuart Cunningham
Clerk

/s/ McClendon Grice
Deputy Clerk

Supreme Court, U.S.
FILED
NOV 4 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-589

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1988

**MICHAEL SULLIVAN,**

*Petitioner,*

v.

**HARTFORD ACCIDENT & INDEMNITY COMPANY,**

*Respondent,*

and

**FORD CITY BANK,**

*Respondent.*

## BRIEF OF RESPONDENT FORD CITY BANK IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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## QUESTION PRESENTED

Whether the Seventh Circuit correctly held that the District Court did not have subject matter jurisdiction over a state law claim asserted by a defendant (Petitioner) against a newly impleaded non-diverse party (Respondent-Bank) where:

1. Subject matter jurisdiction over the plaintiff's claim against defendant-Petitioner was based upon diversity of citizenship;

2. Petitioner's claim admittedly was not a third-party claim under F.R.Civ.P. 14(a) and did not seek to hold the Bank liable for "all or part of" plaintiff's claims against defendant-Petitioner; and

3. Petitioner's claim arose "at different times and from different events" than did the underlying federal claim, and the two claims were "not . . . logically entwined in the sense that the decision in one suit would necessarily decide the other by operation of collateral estoppel or otherwise."

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| QUESTION PRESENTED | i |
| TABLE OF CONTENTS | ii |
| TABLE OF AUTHORITIES | iii |
| STATEMENT OF THE CASE | 2 |
| The Pertinent Substantive Facts | 2 |
| The District Court Proceedings | 3 |
| Proceedings In The Court Of Appeals | 3 |
| SUMMARY OF ARGUMENT | 4 |
| ARGUMENT | 5 |
| THE SEVENTH CIRCUIT'S DETERMINATION THAT THE DISTRICT COURT LACKED JURISDICTION OVER PETITIONER'S CLAIM AGAINST THE RESPONDENT-BANK IS CONSISTENT WITH SETTLED LAW, CREATES NO CONFLICT AMONG THE CIRCUITS, AND WILL NOT IMPROPERLY CONSTRICT THE JURISDICTION OF THE FEDERAL COURTS | 5 |
| CONCLUSION | 10 |

## TABLE OF AUTHORITIES


| | PAGE |
|---|---|
| *Aldinger v. Howard*, 427 U.S. 1 (1976) ..... | 7 |
| *Birmingham Fire Ins. v. Wingardner and Hammons, Inc.*, 714 F.2d 548 (5th Cir. 1983) ... | 6 |
| *Field v. Volkswagenwerk AG*, 626 F.2d 293 (3d Cir. 1980) ..... | 5, 6 |
| *Finkle v. Gulf & Western Mfg. Co.*, 744 F.2d 1015 (3d Cir. 1984) ..... | 6 |
| *H.L. Peterson Company v. Applewhite*, 383 F.2d 430 (5th Cir. 1967) ..... | 5, 6 |
| *Owen Equip. & Erection Co. v. Kroger*, 437 U.S. 365 (1978) ..... | 3, 7, 8, 9 |
| *Rogers v. Aetna Casualty and Surety Co.*, 601 F.2d (5th Cir. 1979) ..... | 5, 6 |
| *Saalfrank v. O'Daniel*, 533 F.2d 323 (3d Cir.), *cert. denied*, 429 U.S. 922 (1976) ..... | 5, 6 |
| *Sullivan v. Hartford Accident & Indemnity Co.*, 846 F.2d 377 (7th Cir. 1988) ..... | *passim* |
| *Travelers Ins. Co. v. First Nat'l Bank*, 675 F.2d 633 (5th Cir. 1982) ..... | 6 |
| *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966) . | 7 |

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1988

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**MICHAEL SULLIVAN,**

*Petitioner,*

v.

**HARTFORD ACCIDENT & INDEMNITY COMPANY,**

*Respondent,*

**and**

**FORD CITY BANK,**

*Respondent.*

---

## BRIEF OF RESPONDENT FORD CITY BANK IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Respondent Ford City Bank[1] ("Respondent-Bank") prays that the Petition for Writ of Certiorari be denied with respect to Question 1 stated on page i of the Petition.[2]

---

[1] Respondent Ford City Bank is now a wholly-owned subsidiary of Cole Taylor Financial Group, Inc. and is presently named Cole Taylor Bank - Ford City.

[2] The Opinion of the Court of Appeals for the Seventh Circuit which is the subject of the Petition comprehends two consolidated appeals, Nos. 87-1784 and 87-1843. Respondent-Bank was a party only to appeal No. 87-1784, and Question 1 pertains to that appeal. Respondent-Bank takes no position with respect to Question 2 which pertains only to Appeal No. 87-1843 and has no bearing on Question 1.

## STATEMENT OF THE CASE

Petitioner's statement of the case is inaccurate insofar as it pertains to the jurisdictional issue. Respondent-Bank offers the following statement.

### The Pertinent Substantive Facts

Richard Orlak and two officers of Respondent-Bank conspired to defraud it into making real estate loans to Orlak between 1972 and early 1974. (A-1 - 3). Petitioner, Orlak's attorney and co-venturer, was a beneficiary of one of the fraudulent loans, in connection with which he assigned to Respondent-Bank his 50% beneficial interest in an Illinois land trust as collateral security for all past and future indebtedness of Orlak. (A-2 - 3 and A-30).

Orlak filed for bankruptcy in early 1974, owing Respondent-Bank several million dollars. (A-3 and A-41). In September 1974, as part of an effort to foreclose on its security for Orlak's indebtedness, Respondent-Bank demanded that Petitioner unconditionally assign it his previously pledged collateral. (A-41 - 42). Petitioner did so. After liquidating all of its collateral, Respondent-Bank still incurred a loss of over $1.5 million on its loans to Orlak. (A-3).

In 1976, Respondent-Bank made a claim against Respondent Hartford Accident & Indemnity Company ("Hartford") on a fidelity bond covering the Bank officers (Beede and Quinn) who had conspired with Orlak to defraud it, settled that claim, and assigned to Hartford all of its rights against Orlak, Beede, Quinn and Petitioner. (A-3 - 4).

**The District Court Proceedings**

Hartford sued Petitioner on two assigned claims which arose out of transactions occurring between 1972 and early 1974.

Petitioner impleaded the Bank pursuant to a pleading entitled "Counterclaim and Third Party Complaint" which asserted that the Bank's September 1974 demand upon Petitioner breached a fiduciary duty imposed on the Bank because it was Petitioner's land trustee.

The District Court entered judgment, *inter alia*, against Hartford and for Petitioner on the Complaint, and entered judgment for Petitioner and against the Bank on the "Counterclaim and Third Party Complaint."

**Proceedings In The Court Of Appeals**

Respondent-Bank argued that the District Court erred, under the applicable Illinois statute, in holding that it owed Petitioner any fiduciary duty in September 1974, and that it erred in assuming subject matter jurisdiction over Petitioner's claim because it did not satify the tests for ancillary jurisdiction over third-party claims set forth in *Owen Equip. & Erection Co. v. Kroger*, 437 U.S. 305 (1978).

Petitioner argued that his claim was not a third-party claim and that *Owen* did not apply even if it was, but took the position that it was within the District Court's "ancillary" jurisdiction because it was a "compulsory counterclaim" which arose out of the "same transaction or occurrence" as plaintiff's claims.

The Seventh Circuit analyzed all of the claims and the context in which they were asserted and rejected the factual premise for Petitioner's argument, holding (A-9) that:

> The proper analogy to Sullivan's claim against Ford City Bank is permissive, not compulsory, counterclaim. Hartford's claim against Sullivan arises out of the fraudulent scheme by Orlak and others to defraud the Bank, while Sullivan's claim against the Bank arises out of the Bank's efforts to cut its losses by foreclosing the Neuport Estates loan *after* the frauds were discovered. The claims involved considerable factual overlap, of course, but they arise at *different times* from *different events* and thus flunk the test of same transaction or occurrence. (Emphasis added).

The Seventh Circuit further applied the "logical dependency" rationale of *Owen* and held that, while Hartford's claims and Petitioner's claims were "related, . . . they are not . . . logically entwined in the sense that the decision in one suit would necessarily decide the other. . . ." (A-5).

## SUMMARY OF ARGUMENT

The Seventh Circuit's decision was correct and is consistent with the decisions of other Circuit Courts of Appeal and with this Court's decision in *Owen*. Petitioner has cited no case which holds or suggests that "ancillary" jurisdiction properly extends to a claim against a newly impleaded non-diverse party where the claim does not arise out of the "same transaction or occurrence" as the plaintiff's claim against the defendant within the meaning of F.R.Civ.P. 13(a) and where that claim does not seek to hold the impleaded party liable "for all or a part of" the plaintiff's claim against the defendant within the meaning of F.R.Civ.P. 14(a).

## ARGUMENT

**THE SEVENTH CIRCUIT'S DETERMINATION THAT THE DISTRICT COURT LACKED JURISDICTION OVER PETITIONER'S CLAIM AGAINST THE RESPONDENT-BANK IS CONSISTENT WITH SETTLED LAW, CREATES NO CONFLICT AMONG THE CIRCUITS, AND WILL NOT IMPROPERLY CONSTRICT THE JURISDICTION OF THE FEDERAL COURTS.**

(1) Petitioner first argues that the decision is in conflict with the decisions of the Fifth and Third Circuits in *Rogers v. Aetna Casualty and Surety Co.*, 601 F.2d 840, 843 and n.4 (5th Cir. 1979); *H.L. Peterson Company v. Applewhite*, 383 F.2d 430, 433 (5th Cir. 1967); *Saalfrank v. O'Daniel*, 533 F.2d 325, 329 (3d Cir.), *cert. denied*, 429 U.S. 922 (1976); and *Field v. Volkswagenwerk AG*, 626 F.2d 293, 298-99 (3d Cir. 1980). It is not.

Petitioner claims that these decisions stand for the general proposition that *any* claim against a newly impleaded party is the proper subject of ancillary jurisdiction so long as it is denominated a "third-party" claim and is somehow "related" to the underlying federal claim. (Pet. p. 10).

This is patently not what these cases hold. Rather, they simply hold that ancillary jurisdiction may be invoked over true third-party claims for indemnity, contribution, or other forms of derivative liability by which a defendant seeks to hold an impleaded party liable under Rule 14(a) "for all or part" of the plaintiff's claim against him. All of the cases relied upon by Petitioner involve Rule 14(a) claims for contribution or indemnity. *Rogers*, 601 F.2d at

843; *Peterson*, 383 F.2d at 432; *Saalfrank*, 533 F.2d at 327; and *Field*, 626 F.2d at 299.[3]

Petitioner's claim against Respondent-Bank, however, did *not* seek contribution or indemnity for his liability to Hartford, nor did it even purport to be a third-party claim under Rule 14(a). These admissions were expressly made by Petitioner in his Brief to the Seventh Circuit (Sullivan Brief at 14):

> Ford City Bank misconstrues Sullivan's joinder of it as an impleader of a third-party defendant under Federal Rule of Civil Procedure 14(a).
>
> * * * *
>
> But Sullivan did not invoke the standard of Rule 14(a) that if he is liable to the Hartford, then the Ford City Bank is liable to him, and the pleadings do not even remotely suggest such a claim.

The cases cited by Petitioner are therefore inapposite to the admitted jurisdictional facts of this case. They all involve ancillary jurisdiction over Rule 14(a) third-party indemnity and contribution claims. This case admittedly does not involve such facts, nor did the Seventh Circuit hold or suggest that ancillary jurisdiction is not appropriate in such circumstances. There is no conflict.

---

[3] Moreover, to the extent any of these cases arguably could be read to stand for a broader rule, they do not reflect the present state of the law in either the Fifth or Third Circuits, both of which now recognize that state law claims against newly impleaded non-diverse parties are not the proper subject of ancillary jurisdiction unless they both: (1) arise out of the same nucleus of operative facts as the underlying claim; and (2) are "logically dependent" upon the underlying claim. *See Birmingham Fire Ins. v. Winegardner and Hammons, Inc.*, 714 F.2d 548 (5th Cir. 1983); *Travelers Ins. Co. v. First Nat'l Bank*, 675 F.2d 633 (5th Cir. 1982); and *Finkle v. Gulf & Western Mfg. Co.*, 744 F.2d 1015 (3d Cir. 1984).

(2) Petitioner next argues that the decision is contrary to this Court's decision in *Owen* because the facts of this case satisfy the "logical dependence" test set forth therein. This argument is: directly contrary to the position taken by Petitioner in the Seventh Circuit; directly contrary to the Seventh Circuit's finding; and is ultimately unavailing because Petitioner does not even argue that he fulfilled all of the *other* separate and independent requirements for ancillary jurisdiction mandated by *Owen*.

Petitioner's reliance upon *Owen* is directly contrary to the position he took in the Seventh Circuit (Sullivan Brief at 14-15) where he argued both that his claim was not a third-party claim, and that, even if it was so construed, the "logical dependency" test set forth in *Owen* still did *not* apply to it:

> If this Court construes the addition of Ford City Bank as an impleaded third-party defendant . . . , Sullivan argues . . . that *Owen* does not require a logical dependency test to be applied to third party complaints.

Moreover, even if Petitioner were permitted to avoid his prior contrary position, his factual argument is without merit because, as the Seventh Circuit correctly found, his claim flunked the "logical dependency" test.

*Owen* involved a state law claim brought under Rule 14(a) by a plaintiff against a non-diverse party who had previously been impleaded by defendant.

In holding that ancillary jurisdiction did *not* properly extend to that claim, this Court reiterated two separate tests for "ancillary" jurisdiction—the "common nucleus" test deriving from *United Mine Workers v. Gibbs*, 383 U.S. 715, 725 (1966), and the "statutory" test deriving from *Aldinger v. Howard*, 427 U.S. 1, 14-15 (1976). It also

added a third test—that the claim must be "logically dependent" upon the outcome of the federal claim. *Owen*, 437 U.S. at 376. A true third-party claim which comports with Rule 14(a) by seeking recovery "for all or a part of" the liability sought to be imposed upon on the claimant is the paradigm of "logical dependency" because such a claim "depends at least in part upon the resolution of the primary lawsuit." *Id.*

Petitioner's claim itself did not allege that it depended upon the resolution of plaintiff's claims against him. Petitioner further conceded that it was *not* a third-party claim conforming to Rule 14(a). Moreover, the Seventh Circuit applied the rationale of *Owen* and held (A-5) that there was *in fact* no relationship of "logical dependence" between the two claims:

> The issues in the two suits are closely related, but they are not identical, nor logically entwined in the sense that the decision in one suit would necessarily decide the other by operation of collateral estoppel or otherwise. None of the parties argues that if Hartford wins, Ford City must win, or that if Hartford loses, Ford City must lose.

This conclusion was patently correct. Hartford won but the Bank lost. The Bank's alleged liability to Petitioner therefore obviously did *not depend* at all upon whether or not Petitioner was liable to Hartford; nor was Respondent-Bank's non-liability to Petitioner established by Petitioner's non-liability to Hartford. Had there been any relationship of "logical dependence," Petitioner's claim would have had to have been dismissed (or at least diminished) upon his successful defense of Hartford's claims. It was not.

Finally, the "logical dependence" issue need not even be reached by this Court in denying the Petition. Ancillary jurisdiction may *never* be invoked, as a Constitutional matter, unless the claim arises out of "the same common nucleus of operative facts" as the federal claim. *Owen*, 437 U.S. at 391. The Seventh Circuit correctly found that the "common nucleus" standard was not satisfied here because the two claims arose "at different times from different events." (A-9). Petitioner has not sought review of that finding. Accordingly, even if the "logical dependence" test had been fulfilled, the decision is still correct and would have to be affirmed on a dispositive ground as to which Petitioner has not even sought review by this Court.

(3) Petitioner's final argument (Pet. 13-14) is that this decision ignores public policy and will mandate "waste" in the administration of justice in the Seventh Circuit. This argument is without merit.

The Seventh Circuit's careful analysis was very fact specific, did not enunciate any general rule applicable beyond the peculiar facts of this case, and gave appropriate recognition to the policy considerations inherent in the judge-made doctrine of ancillary jurisdiction. (A-4 - 10). This decision, therefore, does not purport to and cannot have any impact upon the generally recognized application of that doctrine to Rule 14(a) claims against new parties who may be liable to a defendant "for all or a part of" the liability sought to be imposed upon him (and which otherwise satisfy the requirements of *Owen*), or to Rule 13(a) "compulsory" counterclaims.

## CONCLUSION

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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**November 4, 1988**

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